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S. HRG. 98-629 Part II

COMPETITIVE EQUITY IN THE FINANCIAL SERVICES INDUSTRY

HEARINGS

BEFORE THE

COMMITTEE ON
BANKING, HOUSING, AND URBAN AFFAIRS
UNITED STATES SENATE

NINETY-EIGHTH CONGRESS

SECOND SESSION

ON

S. 2181

TO AUTHORIZE DEPOSITORY INSTITUTION HOLDING COMPANIES TO ENGAGE IN ACTIVITIES OF A FINANCIAL NATURE, INSURANCE UNDERWRITING AND BROKERAGE, REAL ESTATE DEVELOPMENT AND BROKERAGE, AND CERTAIN SECURITIES ACTIVITIES INCLUDING DEALING IN, UNDERWRITING AND PURCHASING GOVERNMENT AND MUNICIPAL SECURITIES, SPONSORING AND MANAGING INVESTMENT COMPANIES AND UNDERWRITING THE SECURITIES THEREOF, TO PROVIDE FOR THE SAFE AND SOUND OPERATION OF DEPOSITORY INSTITUTIONS, TO AMEND THE FEDERAL RESERVE ACT, THE HOME OWNERS' LOAN ACT OF 1933, AND THE BANK SERVICE CORPORATION ACT, AND FOR OTHER PURPOSES

S. 2134

TO ESTABLISH THE PERMISSIBLE SCOPE OF POWERS FOR DEPOSITORY INSTITUTIONS AND THEIR HOLDING COMPANIES CONSISTENT WITH THEIR SAFE AND SOUND OPERATIONS, TO SIMPLIFY THE PROCEDURES FOR ENGAGING IN SUCH ACTIVITIES, AND FOR OTHER PURPOSES

PART II

FEBRUARY 22, 28, AND 29, 1984

Printed for the use of the Committee on Banking, Housing, and Urban Affairs

32-411-16

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COMPETITIVE EQUITY IN THE FINANCIAL SERVICES INDUSTRY

PART II

WEDNESDAY, FEBRUARY 22, 1984

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, D.C.

The committee met at 9:30 a.m., in room SD–538, Dirksen Senate Office Building, Senator Jake Garn (chairman of the committee) presiding.

Present: Senators Garn, Heinz, Armstrong, Gorton, Hecht, Humphrey, Proxmire, and Sasser.

OPENING STATEMENT OF CHAIRMAN GARN

The CHAIRMAN. The Banking Committee will come to order.

Today we continue our hearings on legislation designed to bring our laws more current with the marketplace of today. The subject of today's hearing is S. 2181, the Financial Services Competitive Equity Act, which I introduced to deal, among other things, with powers of bank holding companies, interstate banking operations, bank acquisitions by insurance companies, securities firms, real estate, and other similar financial service organizations, interest on checking accounts, and check holding policies of banks. My proposal, based principally on legislation originally drafted by the Treasury Department, also contains legislative proposals introduced separately during the past year by several Senators. Senator Proxmire of Wisconsin has introduced a bill, S. 2134, addressing some of these same issues, which is also a focus of these hearings.

The committee held a hearing on these legislative proposals on January 16 in Salt Lake City. From 9:30 a.m. to 6 p.m., Utah State regulators and representatives of Utah and Western banking, thrift, insurance, securities, and real estate groups appeared before the committee. Over 230 people were in attendance at the hearing. It was enlightening and informative for Senators Gorton, Lautenberg, and I to hear the views of knowledgeable local witnesses speaking about their day-to-day experiences as hands-on financial service executives. Those people would not otherwise have had an opportunity to testify before this committee, and we would not otherwise have been able to hear their contributions. I regret that we cannot hold many more hearings outside of Washington.

Many people think that I started bank deregulation, but it began long ago because of technological innovations and the resulting better accuracy in accounting for money. Also, innovative financial thinkers have been figuring out daily how to meet consumers' demands for higher returns and more convenience by changing the effect and form of regulation.

The financial services industry is definitely a changing landscape. It used to be that there was one road for banks, one for thrifts, one for securities firms, and one for insurance companies. Today, there are countless unpaved routes crossing the old main roads, many of which have provided consumers with better, more efficient financial services. Unfortunately, these are not used by or available to all competitors. The question for this committee is to consider the effects of these new paths and whether it is in the public interest to pave them and provide access to all, or close them and retain the existing system.

I also caution those who are concerned about sections of my bill to consider how much S. 1720 changed before it became law as the Garn-St Germain Act. In many places across this country there are people who don't seem to understand or who don't want to understand the legislative process. This is the beginning of that process and my point about S. 1720 to those who would panic because they don't like particular provisions of the bill, is that there are provisions in there for the purpose of discussion, for the purpose of holding these hearings and giving people their opportunity to have their day in court and be heard on how they feel. So to those who would panic because Senator Proxmire and I both have bills in that somehow these are already accomplished fact; they are not. For those who would just look at the difference between S. 1720 and Garn-St Germain, I think they could only come to one conclusion, that we are in a legislative process. If we were not, there would be no purpose in holding hearings or listening to anyone. So there's still a long process to go through. This is only the second of many hearings, so please, all of you and those who are reporting it to others who will testify later, don't panic. There will be a lot of changes before we ever get to a markup on this particular bill.

We have 8 days of hearings scheduled on this bill throughout February and March in order that the thoughts and concerns of regulators, business groups, and consumers can be fully and completely heard and factored into the process of crafting mutually acceptable legislation to modernize our banking laws.

[Copies of bills S. 2181 and S. 2134 follow:]

II

98TH CONGRESS
1ST SESSION

S. 2181

To authorize depository institution holding companies to engage in activities of a financial nature, insurance underwriting and brokerage, real estate development and brokerage, and certain securities activities including dealing in, underwriting and purchasing government and municipal securities, sponsoring and managing investment companies and underwriting the securities thereof, to provide for the safe and sound operation of depository institutions, to amend the Federal Reserve Act, the Home Owners' Loan Act of 1933, and the Bank Service Corporation Act, and for other purposes.

IN THE SENATE OF THE UNITED STATES

NOVEMBER 18 (legislative day, NOVEMBER 14), 1983

Mr. GARN introduced the following bill; which was read twice and referred to the Committee on Banking, Housing, and Urban Affairs

---

A BILL

To authorize depository institution holding companies to engage in activities of a financial nature, insurance underwriting and brokerage, real estate development and brokerage, and certain securities activities including dealing in, underwriting and purchasing government and municipal securities, sponsoring and managing investment companies and underwriting the securities thereof, to provide for the safe and sound operation of depository institutions, to amend the Federal Reserve Act, the Home Owners' Loan Act of 1933, and the Bank Service Corporation Act, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SHORT TITLE OF ACT

Section 1. This Act may be cited as the "Financial Services Competitive Equity Act".

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Sec. 103. Amendments to the Securities Exchange Act.
Sec. 104. Amendments to the Bank Holding Company Act.
Sec. 105. Amendment to the Federal Reserve Act.
Sec. 106. Amendments to the Investiment Company Act of 1940.
Sec. 107. Amendments to the Bank Holding Company Act Amendments of 1970.
Sec. 108. Amendments to the National Housing Act.
Sec. 109. Amendments to the Home Owners' Loan Act of 1933.
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TITLE II—CREDIT UNION AMENDMENTS

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TITLE IV—COMPETITIVE SAVINGS INCENTIVE

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TITLE I—FINANCIAL INSTITUTIONS COMPETITIVE EQUITY

AMENDMENTS TO THE BANKING ACT OF 1933

SEC. 101. (a) Section 20 of the Banking Act of 1933 (12 U.S.C. 377) is amended by inserting the following new paragraph after the first paragraph of such section:

"Notwithstanding any other provision of this section, a member bank may be affiliated in any manner described in section 2(b) with a depository institution securities affiliate as defined in section 2(j) of the Bank Holding Company Act of 1956, as amended (12 U.S.C. 1841(j)).".

(b) Section 32 of the Banking Act of 1933 (12 U.S.C. 78) is amended by inserting the following sentence at the end of the first paragraph of such section: "Notwithstanding any other provision of this section, an officer, director, or employee of any member bank may serve at the same time as an officer, director, or employee of any of its depository institution securities affiliates. The term 'depository institution securities affiliate' shall have the meaning ascribed to it in section 2(j) of the Bank Holding Company Act of 1956, as amended (12 U.S.C. 1841(j)).".

AMENDMENTS TO THE SECURITIES ACT OF 1933

SEC. 102. Section 4 of the Securities Act of 1933 (15 U.S.C. 77d) is amended adding at the end thereof the following:

"(7) Transactions involving offers or sales of equity securities, in connection with the acquisition of a bank by a company under the Bank Holding Company Act of 1956 (12 U.S.C. 1841 et seq.), or in connection with the acquisition of an insured institution by a company under the Savings and Loan Holding Company Amendments of 1967 (12 U.S.C. 1730a), if such acquisition occurs solely as part of a reorganization in which a person or group of persons exchange their shares of a bank or insured institution for shares of a newly formed bank holding company or savings and loan holding company and receive, after such reorganization, substantially the same proportional share interests in the holding company as they held in the bank or insured institution, except for changes in shareholder interests resulting from the exercise of dissenting shareholder rights under State law.".

AMENDMENTS TO THE SECURITIES EXCHANGE ACT

SEC. 103. (a) Subparagraphs (i), (ii), and (iii) of paragraph (34)(A) of subsection 3(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(34)(A)) are each amended by inserting immediately before the semicolons at the end thereof the following: "other than a depository institution securities affiliate as defined in section 2(j) of the Bank Holding Company Act of 1956 (12 U.S.C. 1841(j)) or as defined in section 408(a)(1)(K) of the National Housing Act (12 U.S.C. 1730a(a)(1)(K))".

(b) Section 15B(b)(1) of the Securities Exchange Act of 1934 (15 U.S.C. 78o-4(b)(1)) is amended by striking out "subsidiaries" in subparagraphs (B) and (C) and inserting in lieu thereof "affiliates".

AMENDMENTS TO THE BANK HOLDING COMPANY ACT

SEC. 104. (a) Section 2 of the Bank Holding Company Act of 1956 (12 U.S.C. 1841) is amended—

(1) by amending subsection (c) to read as follows:

"(c) 'Bank' means (1) an 'insured bank' as defined in section 3(h) of the Federal Deposit Insurance Act; or (2) any institution organized under the laws of the United States, any State of the United States, the District of Columbia, any territory of the United States, Puerto Rico, Guam, American Samoa, or the Virgin Islands, that accepts deposits that the depositor may withdraw by check or similar means for payment to third parties and is engaged in the business of making commercial loans. The term 'bank' does not include (A) any foreign bank having an insured branch; (B) an insured institution; (C) any organization operating under section 25 or section 25(a) of the Federal Reserve Act; (D) any organization that does not do business in the United States except as an incident to its activities outside the United States; or (E) any consumer bank as defined in subsection (k) of this section or any industrial bank, Morris Plan bank, industrial loan company or similar institution, operated in the manner authorized by State law, that does not both engage in the business of making commercial loans and accept deposits that the depositor has a legal right to withdraw on demand."; and

(2) by inserting after subsection (i) the following new subsections:

"(j) The term 'depository institution securities affiliate' means any corporation that (1) is engaged in the United States in one or more of the activities authorized pursuant to section 4(c)(15) of this Act, and (2) is a broker or dealer within the meaning of paragraph (4) or (5) of section 3(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)), or an investment adviser within the meaning of section 202(11) of the Investment Advisers Act of 1940 (15 U.S.C. 80b-2(11)). For purposes of this Act, a corporation engaged in any such activities shall be deemed to be a depository institution securities affiliate only so long as it is a bank holding company or is owned or controlled by a bank holding company.

"(k) The term 'consumer bank' means any institution that would otherwise be a 'bank' under subsection (c) of this section but that does not engage in the business of making commercial loans.

"(l) the term 'commercial loans' does not include (i) loans to natural persons primarily for personal, family, or household purposes, whether directly, indirectly or through the use of leases; (2) loans for charitable persons; (3) loans secured by residential real property; (4) loans to natural persons through use of credit cards or similar means of access; or (5) investments such as commercial paper, certificates of deposit, bankers acceptances and similar money market instruments, the extension of broker call loans, the sale of Federal funds, the deposit of interest-bearing funds, mortgage-backed securities, obligations of the United States and local and State governments, or agencies and instrumentalities thereof, and such other similar types of investments as may be permitted by the institution's primary regulator. An institution shall not be deemed to 'engage in the business of making commercial loans' if the aggregate principal amount of its outstanding commercial loans represented by (A) credit to finance the inventorying of goods generally being acquired by natural persons; (B) loans to small business concerns; and (C) similar loans, does not exceed 5 percent of the institution's total assets.

"(m) For purposes of this Act—

"(1) the term 'depository institution holding company' means a bank holding company;

"(2) the term 'depository institution' means bank; and

"(3) the terms 'savings and loan holding company' and 'insured institution' have the meanings ascribed to them in section 408(a)(1) of the National Housing Act.".

(b) Section 3 of the Bank Holding Company Act of 1956 (12 U.S.C. 1842) is amended—

(1) by inserting before the period at the end of the second sentence of subsection (a) the following: "; or (C) with thirty days prior notification to the Board, the acquisition by a company of control of a bank in a reorganization in which a person or group of persons exchange their shares of the bank for shares of a newly formed bank holding company and receive, after such reorganization, substantially the same proportional share interest in the holding company as they held in the bank except for changes in shareholder interests resulting from the exercise of dissenting shareholder rights under State law if, immediately following such acquisition, the bank holding company meets the capital and other financial standards prescribed by the Board by regulation for such a bank holding company and the holding company does not engage in any activities other than those of banking or managing and controlling banks. In promulgating regulations pursuant to this subsection, the Board shall not require more capi-

tal for the subsidiary bank immediately following the reorganization that is required for a similarly sized bank that is not a subsidiary of a bank holding company."; and

(2) by adding at the end thereof the following:

"(f) No company may acquire, directly or indirectly, any voting shares of, interest in, or substantially all of the assets of any additional consumer bank located outside of the State in which the operations of such company's consumer bank subsidiaries were principally conducted on July 1, 1983, unless—

"(1) the acquisition of such shares or assets of a consumer bank in such State by a company controlling a consumer bank in another State is specifically authorized by the statute laws of the State in which such consumer bank is located, by language to that effect and not merely by implication;

"(2) the acquisition of shares or assets of a bank in such State by a bank holding company is specifically authorized by the statute laws of the State in which such bank is located, by language to that effect and not merely by implication; or

"(3) the acquisition of such shares or assets of an industrial bank, Morris Plan bank, industrial loan company, or similar institution by a company is authorized by the statute laws of the State in which such institution is located, by language to that effect and not merely by implication.

For the purpose of this section, the State in which the operations of a company's consumer bank subsidiaries are principally conducted is that State in which total deposits of all such consumer bank subsidiaries are largest.".

(c) Section 4(a)(2) of the Bank Holding Company Act of 1956 (12 U.S.C. 1843(a)(2)) is amended—

(1) by striking out subparagraph (B) and inserting in lieu thereof the following: "(B) those permitted under paragraphs (8) (except for those of an insured institution), (15), and (16) of subsection (c) of this section subject to all the conditions and requirements specified in each respective paragraph or in any order or regulation issued by the Board under such paragraphs"; and

(2) by adding at the end thereof the following: "The two-year period referred to in this paragraph shall not apply to a company that becomes a bank holding company as a result of enactment of the Financial Services Competitive Equity Act and that acquired a bank between July 1, 1983, and the effective date of such Act. A company that becomes a bank holding company as a result of the enactment of the Financial Services Competitive Equity Act, and that controlled

an insured bank on July 1, 1983, may engage in any activity in which it was lawfully engaged, directly or through a subsidiary, on July 1, 1983, and in which it has been engaged continuously since July 1, 1983. The authority conferred by the preceding sentence (i) shall terminate at such time as (I) any covered bank holding company acquires control of an additional bank or an insured institution, (II) its existing subsidiary bank commences accepting deposits that the depositor has a legal right to withdraw on demand and engages in the business of making commercial loans, or (III) any covered bank holding company commences, directly or through a subsidiary, after July 1, 1983, any additional activities, other than those activities authorized pursuant to this act (except for the acquisition of an insured institution), in which it was not engaged on July 1, 1983; and (ii) may be terminated by the Board by order, after opportunity for hearing, if it determines, having due regard to the purposes of this chapter, that such action is necessary to prevent conflicts of interests or unsound banking practices or is in the public interest. Any activities authorized for bank holding companies may not be expanded and any additional activities may not be commenced except in accordance with the requirements, conditions, and limitations applicable to bank holding companies.".

(d) Paragraph 8 of subsection 4(c) of the Bank Holding Company Act of 1956 (12 U.S.C. 843(c)) is amended to read as follows:

"(8)(A) in accordance with the limitations and requirements contained in subparagraphs (B) and (C) of this paragraph, shares of any insured institution, shares of a consumer bank, or shares of any company the activities of which consist of—

"(i) activities that the Board has determined (by order or regulation) to be closely related to banking or managing or controlling banks or (by regulation) to be of a financial nature;

"(ii) insurance underwriting or brokerage; or

"(iii) real estate investment, development or brokerage: *Provided*, That, in the case of real estate investment and development, the percentage of a bank holding company's capital that may be devoted to this activity shall not exceed 5 per centum of such company's primary capital, except that for purposes of this clause, real estate investment and development shall include, but not be limited to, the acquisition, management, and maintenance of developed or undeveloped real estate, but shall not include any form of construction activity.

"(B)(i) No bank holding company shall engage in any activity authorized under this paragraph either de novo or by an acquisition in whole or in part of a going concern, unless the Board has been given sixty days prior written notice of such proposal and, within such period, the Board has not issued an order (I) disapproving the proposal, or (II) suspending the time period in accordance with clause (iii) below.

"(ii) An acquisition may be made prior to the expiration of the disapproval period if the Board issues a written notice of its intent not to disapprove the action. The Board may provide for no notice under this paragraph or notice for a shorter period of time with respect to particular activities. No notice under this paragraph is required in the event a bank holding company establishes de novo an office to engage in any activity previously authorized for such a bank holding company under this paragraph or changes the location of an office engaged in such activity.

"(iii) The notice submitted to the Board shall contain such information as the Board shall prescribe by regulation or by specific request in connection with a particular notice: *Provided, however,* That the Board may only require such information as may be relevant to the nature and scope of the proposed activity and to the Board's evaluation of the criteria provided for in clause (iv) hereof. In the event the Board requires additional relevant information beyond that provided in the notice submitted pursuant to this paragraph, the Board may by order suspend the time period provided in clause (i) hereof until it has received such additional relevant information, and the activity that is the subject of the notice may be commenced within thirty days of the date of such receipt unless the Board issues a disapproval order as provided in clause (i) hereof. Such a suspension order is reviewable under section 9 of this Act.

"(iv) In connection with a notice under this paragraph, the Board may consider the following criteria—

"(I) the managerial resources of the companies involved;

"(II) the adequacy of their financial resources, including their capital, giving consideration to the financial resources and capital of others engaged in similar activities: *Provided*, That the Board shall not require a higher level of capital for any activity subject to Federal or State regulation than would be required by the applicable regulatory authority for a company engaged in such activity, unless the Board shall find that particular circumstances warrant a higher level of capital;

"(III) any practice or arrangement that may adversely affect the independence or impartiality of an affiliated bank in the provision of credit or other services or the terms on which such credit and services are made available, or the availability of such credit;

"(IV) any material adverse effect on the safety and soundness or financial condition of an affiliated bank or banks; and

"(V) with respect to an acquisition subject to subparagraph (i) or (ii) of paragraph (8)(c), compliance with such subparagraph.

"(v) The Board shall by order set forth the reasons for any disapproval under this paragraph. Inaction on any notice or a Board order determining not to disapprove a proposal to engage in an activity that has previously been authorized by regulation under this paragraph shall be final and shall not be subject to judicial review under this Act or in any other manner: *Provided, however,* That any bank holding company may obtain judicial review pursuant to section 9 of this

Act of any Board order not to disapprove a notice under this paragraph if such order contains restrictions or conditions.

"(vi) The Board shall, within one hundred and eighty days of enactment of the Financial Services Competitive Equity Act and from time to time thereafter, promulgate regulations under this paragraph designating particular activities that are closely related to banking or of a financial nature. A bank holding company may petition the Board to determine by regulation that a particular activity is closely related to banking or of a financial nature. The Board may by regulation prescribe limitations on the conduct of any activity or activities authorized under paragraphs (8), (15), and (16) of this subsection consistent with the criteria in subparagraph (B)(iv) hereof and with safe and sound financial practices. In administering this paragraph, the Board shall promote competition between bank holding companies and all other companies engaged in activities of a financial nature or closely related to banking.

"(vii) The regulation required under clause (vi) of this paragraph shall include any activity determined by the Board by regulation prior to enactment of this Act to be so closely related to banking or managing or controlling banks as to be a proper incident thereto. The

Board shall not designate as an activity of a financial nature or closely related to banking within the meaning of this paragraph any activity that is described in paragraph (15) of this subsection or that is prohibited to a member bank or an affiliate of a member bank under sections 16 (12 U.S.C. 24 (Seventh)) or 20 (12 U.S.C. 377) of the Banking Act of 1933.

"(C)(i) No bank holding company that owns or controls one or more banks with consolidated deposits in the United States equal to or exceeding 0.30 per centum of all domestic deposits in the United States shall acquire, merge, or consolidate with, or purchase the assets of, a company engaged in insurance, securities, real estate or other activities permissible under paragraph (8) or (15) of this section hereof if, immediately after and as a result of such acquisition, such bank holding company shall have an investment in any one such activity that exceeds 25 per centum of the consolidated capital of such bank holding company.

"(ii) No company that is engaged in an activity otherwise permissible for bank holding companies under paragraph (8) or (15) of this section shall acquire, merge, or consolidate with, or purchase the assets of, a bank or banks with consolidated deposits in the United States equal to or exceeding 0.30 per centum of all domestic deposits in the United States, if, immediately after and as a result of such acquisition, such company shall have an investment in any one such activity that exceeds 25 per centum of the consolidated capital of such company.

"(D)(i) Notwithstanding any other provision of this paragraph, an acquisition involving direct or indirect control of an insured institution by a bank holding company (except an acquisition resulting from a transaction authorized under section 13(f) of the Federal Deposit Insurance Act or section 408(m) of the National Housing Act) shall be subject to the restrictions of section 3(d) hereof, as if the insured institution were a bank.

"(ii) Except for a branch or branches resulting from an acquisition under section 408(m) of the National Housing Act, any insured institution that becomes a subsidiary of a bank holding company may retain and operate its existing branch or branches, but otherwise its branches shall be subject to locations where a national bank may establish and operate branches in the State in which such insured branch is located.".

(e) Section 4(c) of the Bank Holding Company Act of 1956 (12 U.S.C. 1843(c)) is amended—

(1) by striking out the penultimate sentence thereof;

(2) by striking out the period at the end thereof and inserting in lieu thereof a semicolon; and

(3) by adding at the end thereof the following:

"(15) shares of any depository institution securities affiliate engaged in activities in accordance with the limitations contained in this paragraph:

"(i) No depository institution holding company that establishes or acquires any depository institution securities affiliate pursuant to this paragraph shall, after one year from the date on which any such depository institution securities affiliate first engages in any of the activities authorized under subparagraph (iii) of this paragraph, permit any depository institution contolled by such depository institution holding company to engage, directly or through a subsidiary, in the United States in any of the activities authorized under such subparagraph (iii) of this paragraph or any of the following activities, which are authorized pursuant to paragraph Seventh of section 5136 of the Revised Statutes of the United States, as amended (12 U.S.C. 24): dealing in and underwriting obligations of the United States, general obligations of any State of the United States or any political subdivision thereof and other obligations listed in paragraph Seventh of such section 5136 and purchasing and selling securities and stock as agent. For purposes of this paragraph, the Board may, by regulation or order, determine other securities or securities-related activities in which depository institutions may not engage. No rule, regulation or order of the Board, however, shall prohibit a depository institution from engaging in those securities or securities-related activities that are necessary or incidental to the financing of such depository institution or the investment of its funds. In the event that a depository institution holding company terminates all of the activities specified in subparagraph (iii) of this paragraph of its depository institution securities affiliate, any depository institution subsidiary of such holding company may conduct, directly or through a subsidiary, any securities or securities-related activities that it is authorized by law to conduct.

"(ii) Any depository institution securities affiliate may conduct any securities or securities-related activity that a national banking association, as such term is used in section 21 of this title, is not prohibited from conducting.

"(iii) In addition to the activities referred to in subparagraphs (i) and (ii) of this paragraph, such depository institution securities affiliate may—

"(I) deal in and underwrite all obligations issued or guaranteed by or on behalf of a State or any political subdivision thereof or any agency or instrumentality of either of the foregoing, except industrial development bonds as defined in section 103(b)(2) of the Internal Revenue Code of 1954, as amended: *Provided, however,* That depository institution securities affiliates may deal in and underwrite such industrial development bonds, the interest on which is exempt from Federal income tax under section 103(a) of the Internal Revenue Code of 1954, as amended, if: (i) a State, territory, possession of the United States, or any political subdivision of the foregoing, or the District of Columbia pledges its full faith and credit for the payment of all principal and interest on such bonds or (ii) the issuer, or the State or local governmental unit on behalf of which the industrial development bonds were issued, is considered the sole owner, for Federal income tax purposes, of the facility with respect to which financing is to be provided from the proceeds of such industrial development bonds;

"(II) organize, sponsor, operate, and control an investment company, as such term is defined in section 3 of the Investment Company Act of 1940, as amended;

"(III) render investment advice to: (1) an investment company as described in subparagraph (B) above; and any investment company other than a closed-end investment company;

"(IV) underwrite, distribute, and sell securities of any investment company, as such terms are defined in section 3 of the Investment Company Act of 1940; and

"(V) deal in and underwrite promissory notes secured by real estate mortgages and participation interests in such notes or mortgage related payment bonds secured by such notes or participation interests. For purposes of this subparagraph, a mortgage related payment bond means an obligation (which may be with or without recourse to the issuer thereof) which, by its terms, provides for payments of principal in relation to payments, or reasonable projections of payments, on notes meeting the above requirements or participation interests therein which are pledged as security for such obligation and which are rated in one of the four highest rating categories by at least one nationally recognized statistical rating organization.

"(iv) A bank holding company seeking to acquire shares of a depository institution securities affiliate or engage directly in securities or securities-related activities pursuant to this paragraph shall comply with the notice and other requirements of clauses (i) through (vi) of paragraph (8)(B) of this subsection; or".

(f) Section 4(c) of the Bank Holding Company Act of 1956 (12 U.S.C. 1843(c)) is amended by adding at the end thereof the following:

"(16) shares of any company engaged in any activity in which a multiple savings and loan holding company was authorized by law or regulation to engage directly on July 1, 1983: *Provided, however,* That the activities of real estate investment and development may only be engaged in within the limitations of clause (iii) of section 4(c)(8)(A) of this Act: *And provided further,* That any conditions and limitations applicable to a savings and loan company with respect to such activities shall likewise be applicable to such a bank holding company, except that a bank holding company seeking to acquire shares of such a company pursuant to this paragraph shall comply with the notice and other requirements of clauses (i) through (vi) of paragraph (8)(B) of this subsection and except that the Board may by regulation prohibit any bank holding company from engaging in such activities or limit their conduct.".

(g) Section 5(c) of the Bank Holding Company Act (12 U.S.C. 1844(c)) is amended to read as follows:

"(c)(1) The Board from time to time may require reports under oath, in such scope and detail as it may determine, of a bank holding company and each subsidiary thereof to keep the Board informed as to whether such companies are complying with the provisions of this chapter and regulations and orders issued thereunder.

"(2) Except where the Board determines that a lesser reporting requirement is appropriate, the Board shall accept in fulfillment of the reporting requirements established by this subsection for nonbank subsidiaries separate reports consisting of (A) for companies subject to the reporting requirements of section 17 of the Securities Exchange Act of 1934 (15 U.S.C. 78q), the same information required to be submitted to the Securities and Exchange Commission under such section (and the rules and regulations thereunder) at the same time such information is so submitted; and (B) for all other companies, the same information as would be required to be submitted under section 13 of the Securities Exchange Act of 1934 (15 U.S.C. 78m) (and the rules and regulations thereunder) by companies subject to the reporting requirements of such Act, that are engaged in the same or similar lines of business, not more frequently than quarterly. In particular circumstances, the Board may require additional information in order to fulfill its responsibilities under this Act.

"(3) The Board may make examinations of each bank holding company and each subsidiary thereof, the cost of which may be assessed against, and paid by, such holding company. The Board shall, however, insofar as possible, minimize the scope and frequency of examinations of nonbank subsidiaries of a bank holding company by utilizing, where feasible, reports of applicable regulatory agencies or other bodies public or private, and by directing, to the extent feasible, the focus of such examinations to the activities or financial condition of such nonbank subsidiaries that may have a materially adverse effect on the safety and soundness or financial condition of a subsidiary bank of the bank holding company.".

(h) Section 7 of the Bank Holding Company Act of 1956 (12 U.S.C. 1846) is amended by striking out the period at the end thereof and inserting in lieu thereof ", except that (1) no State may prohibit the affiliation of a national banking association, as such term is used in section 21 of this title, with a company engaged only in one or more of the activities described in paragraphs (8), (15), and (16) of subsection 4(c) of this Act, and (2) no State may authorize banks which it charters to engage in insurance activities outside such State on a basis different from that authorized for such banks within the State.".

AMENDMENT TO THE FEDERAL RESERVE ACT

SEC. 105. (a) The Federal Reserve Act is amended by inserting after section 23A the following:

SEC. 23B. RESTRICTIONS ON TRANSACTIONS WITH AFFILIATES.—(a) A member bank and its subsidiaries may engage in any of the following transactions, only on terms and under circumstances, including credit standards, that are substantially the same as, or at least as favorable to such bank or its subsidiary as those prevailing at the time for comparable transactions with or involving other nonaffiliated companies or, in the absence of comparable transactions, those terms and circumstances that in good faith would be offered to, or would apply to nonaffiliated companies—

"(1) any covered transaction, as defined in section 23A, with an affiliate;

"(2) the sale of securities or other assets, including assets subject to an agreement to repurchase, to an affiliate;

"(3) the payment of money or the furnishing of services to an affiliate, under contract, a lease, or otherwise;

"(4) any transaction in which an affiliate acts as an agent or broker or receives a fee for its services to the bank or any other person; or

"(5) any transaction or series of transactions with a third party, (A) if an affiliate has a financial interest in the third party, or (B) if an affiliate is a participant in such transaction or series of transactions.

For the purposes of this subsection, any transaction by a member bank with any person shall be deemed to be a transaction with an affiliate of such bank to the extent that the proceeds of the transaction are used for the benefit of, or transferred to, such affiliate.

"(b) A member bank and the affiliates of such bank shall not publish any advertisement or enter into any agreement stating or suggesting that the bank shall in any way be responsible for the obligations of its affiliates; however, a member bank and its affiliates may use similar names.

"(c) A member bank and any subsidiary of such bank—

"(1) shall not purchase as fiduciary any securities or other assets from any affiliate unless such purchases are permitted under the instrument creating the fiduciary relationship, by court order, or by law of the jurisdiction under which the trust is administered; and

"(2) whether acting as principal or fiduciary, shall not knowingly purchase or otherwise acquire, during the existence of any underwriting or selling syndicate, any security a principal underwriter of which is an affiliate of such bank; except that this prohibition shall not apply where the purchase of such securities has been approved, prior to the time at which such securities are initially offered for sale to the public, by a majority of the directors of the bank who are not officers or employees of the bank or any affiliate thereof.

For the purpose of this paragraph, the term 'security' means a 'security' as defined in section 3(a)(10) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(12)); and the term 'principal underwriter' means any underwriter who, in connection with a primary distribution of securities, (A) is in privity of contract with the issuer or an affiliated person of the issuer; (B) acting alone or in concert with one or more persons, initiates or directs the formation of an underwriting syndicate; or (C) is allowed a rate of gross commission, spread, or other profit greater than the rate allowed another underwriter participating in the distribution.

"(d) For the purpose of this section—

"(1) the term 'affiliate' means an 'affiliate' as defined in section 23A of the Federal Reserve Act (12 U.S.C. 371C) excluding a bank; and

"(2) the terms 'bank', 'subsidiary', 'person', and 'security' (other than security as used in subsection (c)) have the same meaning given to them in section 23A of the Federal Reserve Act (12 U.S.C. 371c).".

"(e) The Board may prescribe rules and regulations to administer and carry out the purposes of this section, including rules or regulations to (1) further define terms used in this section; (2) exempt transactions or relationships from the requirements of this section; or (3) exclude from the definition of 'affiliate' in this section any subsidiary of a bank holding company, if the Board finds such exemptions or exclusions to be in the public interest and consistent with purposes of this section.".

(b) Section 18(j) of the Federal Deposit Insurance Act (12 U.S.C. 1828(j) is hereby amended—

(1) by inserting "and section 23B" after "section 23A" at each place it appears in paragraph (1); and

(2) by inserting ", 23B," after "23A" in paragraph (3)(A).

AMENDMENTS TO THE INVESTMENT COMPANY ACT OF 1940

SEC. 106. (a) Section 17(f) of the Investment Company Act of 1940 (15 U.S.C. 80a–17(f)) is amended by inserting after "unit investment trusts" the following: ": *Provided, however,* That any registered management company which is organized, sponsored, operated, or controlled by, or which receives investment advice from, any depository institution securities affiliate, as defined in section 2(j) of the Bank Holding Company Act of 1956 (12 U.S.C. 1841(j)) or in section 408(a)(1)(K) of the National Housing Act (12 U.S.C. 1730a(a)(1)(K)), may place and maintain its securities and similar investments in the custody of a bank which is affiliated with such depository institution securities affiliate only with the prior approval of the Commission".

(b) Section 26(a)(1) of the Investment Company Act of 1940 (15 U.S.C. 80a–26(a)(1)) is amended by inserting after "so published);" the following: ": *Provided, however,* That, except with the prior approval of the Commission, it shall be unlawful for such trust indenture, agreement of custodianship, or other instrument to designate as trustee or custodian any bank which is affiliated with a depository institution securities affiliate, as defined in the Bank Holding Company

Act of 1956 (12 U.S.C. 1841(j)) or in section 408(a)(1)(K) of the National Housing Act (12 U.S.C. 1730a(a)(1)(K)), which organizes, sponsors, operates or controls such registered unit investment trust".

(c) Section 27(c)(2) of the Investment Company Act of 1940 (15 U.S.C. 80–27(c)(2)) is amended by inserting after "trust indentures of unit investment trusts" the following: ": *Provided, however,* That, except with the prior approval of the Commission, it shall be unlawful to deposit such proceeds with any bank which is affiliated with a depository institution securities affiliate, as defined in section 2(j) of the Bank Holding Company Act of 1956 (12 U.S.C. 1841(j)) or in section 408(a)(1)(K) of the National Housing Act (12 U.S.C. 1730a(a)(1)(K)), which organizes, sponsors, operates, controls or renders investment advice to such registered investment company".

AMENDMENTS TO BANK HOLDING COMPANY ACT AMENDMENTS OF 1970

SEC. 107. Section 106 of the Bank Holding Company Act Amendments of 1970 (12 U.S.C. 1971 et seq.) is amended—

(1) by redesignating subsections (c) through (h) as subsections (d) through (i), respectively; and

(2) by inserting after subsection (b) the following:

"(c) A bank shall—

"(1) explain in writing to a person who solicits credit with reference to which insurance is or may be required that such insurance may be purchased from an insurer or agent of such person's choice, and shall not directly or indirectly solicit such insurance until it has given such person a commitment in writing that the credit solicited shall be extended;

"(2) not unreasonably reject a contract of insurance furnished by a borrower for the protection of the property securing the credit or lien, and shall not reject such a contract without giving the borrower a statement in writing stating the reasons therefor, nor shall it require that any borrower, mortgagor, purchaser, insurer, broker, or agent pay a separate charge in connection with the handling of any contract of insurance required as security for a loan, or pay a separate charge to substitute the insurance policy of one insurer for that of another, nor shall it require any procedures or conditions of duly licensed agents, brokers, or insurers not customarily required of those agents, brokers, or insurers affiliated or in any way connected with the bank;

"(3) not use or disclose, without the prior written consent of the borrower, mortgagor, or purchaser obtained at a time other than the making of the loan or extension of credit, information relative to a contract of insurance which is required by the credit transaction, for the purpose of replacing such insurance;

"(4)(A) accept, with regard to any insurance issued or sold by it or an affiliate thereof, in connection with an extension of credit made by such bank, the cancellation by a borrower of any such insurance if notified by the borrower within 30 days of the effective date of the insurance; and

"(B) refund the unearned portion of the premium to the creditor within twenty days after receipt of a notice of cancellation if no liability for a loss under the insurance has been incurred."; and

(3) by adding at the end of subsection (b)(2) the following:

"(I) Any action for injunctive relief that may be commenced by any person pursuant to subsection (g) may be commenced on behalf of such person by any trade association of which such person is a member. Any such action commenced by a trade association shall be subject to the same requirements, limitations, and conditions as would be applicable had such action been commenced by any such person pursuant to subsection (g).".

AMENDMENTS TO THE NATIONAL HOUSING ACT

SEC. 108. (a) Section 408(a)(1) of the National Housing Act (12 U.S.C. 1730a(a)(1)) is amended—

(1) by amending subparagraph (A) to read as follows:

"(A) 'insured institution' means a Federal savings and loan association, a Federal savings bank, a building and loan, savings and loan or homestead association, or a cooperative bank, the accounts of which are insured by the Federal Savings and Loan Insurance Corporation, and shall include a Federal savings bank or a stock savings bank, the deposits of which are insured by the Federal Deposit Insurance Corporation;";

(2) by amending subparagraph (B) to read as follows:

"(B) 'uninsured institution' means any association or bank referred to in subparagraph (A), the accounts of which are not insured by the Federal Savings and Loan Insurance Corporation, except for a Federal savings bank or stock savings bank, the deposits of which are insured by the Federal Deposit Insurance Corporation; and"; and

(3) by adding at the end thereof the following:

"(K) 'depository institution securities affiliate' means any corporation that (i) is engaged in the United

States in one or more of the activities authorized for depository institution securities affiliates pursuant to section 4(c)(15) of the Bank Holding Company Act of 1956 (12 U.S.C. 1843(c)(15)) and subject to the limitations specified therein, and (ii) is a broker or dealer within the meaning of paragraph (4) or (5) of section 3(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)), or an investment adviser within the meaning of section 202(11) of the Investment Advisers Act of 1940 (15 U.S.C. 80b-2(11)). For purposes of this title, a corporation engaged in any such activities shall be deemed to be a depository institution securities affiliate only so long as it is owned or controlled by a savings and loan holding company. For purposes of applying section 4(c)(15) of the Bank Holding Company Act to this title—

"(i) the term 'depository institution holding company' means savings and loan holding company; and

"(ii) the term 'depository institution' means 'insured institution'.

"(L) 'bank holding company' and 'bank' shall have the meanings ascribed to them in section 2 of the Bank Holding Company Act of 1956 (12 U.S.C. 1841).".

(b) Section 408(c) of the National Housing Act (12 U.S.C. 1730a(c)) is amended to read as follows:

"(c)(1) Except as otherwise provided in this subsection, no savings and loan holding company (except a unitary savings and loan holding company that acquires an insured institution pursuant to subsection (m) of this section) or subsidiary thereof which is not an insured institution shall—

"(A) for or on behalf of such subsidiary insured institution, engage in any activity or render any service for the purposes or with the effect of evading law or regulation applicable to such insured institution; or

"(B) commence or continue, after two years from the date as of which it becomes a savings and loan holding company, any business activity other than those specified in paragraph (2) of this subsection except that such two-year period shall not apply to any company that acquires an insured institution between July 1, 1983, and the effective date of the Financial Services Competitive Equity Act: *Provided*, That any company that becomes subject, as a result of the Financial Services Competitive Equity Act, to the prohibitions of this subparagraph and that controlled an insured institution prior to July 1, 1983, may engage in any activity in which it was lawfully engaged, directly or through a subsidiary, on July 1, 1983, and in which it has been engaged continuously since July 1, 1983: *Provided,* That any activities authorized for savings and loan holding companies may not be expanded and any additional activities may not be commenced except in accordance with the requirements, conditions, and limitations applicable to savings and loan holding companies. The authority conferred by the preceding proviso, (A) shall terminate at such time as any covered savings and loan holding company (i) acquires a bank, or its subsidiary insured institution fails to qualify as a domestic building and loan association under section 7701(a)(19) of the Internal Revenue Code of 1954, or (ii) commences, directly or through a subsidiary, after July 1, 1983, any additional activities, other than those authorized pursuant to this Act to be permissible for savings and loan holding companies (except for the acquisition of a bank), in which it was not engaged on July 1, 1983, or (B) may be terminated by the Corporation, after opportunity for hearing, if it determines, having due regard for the purposes of this chapter, that such action is necessary to prevent conflicts of interests, unsound practices, or in the public interest.

"(2) The prohibitions of subparagraph (1)(B) of this subsection shall not apply to the following business activities—

"(A) furnishing or performing management services for a subsidiary insured institution;

"(B) conducting an insurance agency or escrow business;

"(C) holding or managing or liquidating assets owned or acquired from a subsidiary insured institution;

"(D) holding or managing properties used or occupied by a subsidiary insured institution;

"(E) acting as trustee under deed of trust;

"(F) acquiring shares of any bank and engaging in one or more of the following activities subject to the limitations, conditions, and requirements specified in paragraph (3) of this subsection: (i) activities determined by the Board of Governors of the Federal Reserve System (by regulation) to be of a financial nature or closely related to banking or managing or controlling banks: *Provided, however,* That the Corporation may (by regulation) prohibit or limit any such activity for savings and loan holding companies; (ii) activities in which multiple savings and loan holding companies were authorized (by regulation) to engage directly on July 1, 1983: *Provided, however,* That in the case of real estate investment and development, savings and loan holding companies may only maintain investments lawfully held on July 1, 1983, and make additional investments within the limitations of clause (iv) hereof; (iii) engaging in either or both the activities of insurance underwriting and brokerage; (iv) engaging in one or more of the activities of real estate investment, development, or brokerage: *Provided,* That, in the case of real estate investment and development, the percentage of a savings and loan holding company's capital that may be devoted to this activity shall not exceed 5 per centum of such company's primary capital, except that for purposes of this clause, real estate investment and development shall include, but not be limited to acquisition, management, and maintenance of developed or undeveloped real estate, but shall not include any form of construction activity; and (v) engaging in the activities of a depository institution securities affiliate in accordance with the terms under which such activity may be conducted pursuant to the provisions of paragraph (15) of section 4(c) of the Bank Holding Company Act of 1956 (12 U.S.C. 1843(c)), except that notwithstanding any other provision of this subparagraph, an acquisition involving the direct or indirect control of a bank by a savings and loan holding company (except an acquisition resulting from a transaction authorized under section 13(f) of the Federal Deposit Insurance Act) shall be subject to the restrictions of section 3(d) of the Bank Holding Company Act of 1956, as if any insured institution subsidiary of the savings and loan holding company were a bank and as if the savings and loan holding company were a bank holding company; and

"(G) acquiring shares of any company which is an export trading company, as that term is defined in paragraph (14) of section 4(c) of the Bank Holding Company Act of 1956 (12 U.S.C. 1843(c)), and subject to all the requirements, conditions, and limitations of such paragraph (14) as if the acquiring or establishing savings and loan holding company were a bank holding company within the meaning of that paragraph, except that any notice required to be given pursuant to that paragraph shall be given to the Corporation, which shall have the same authority with respect to such notice procedure for savings and loan holding companies as the Board of Governors of the Federal Reserve System has pursuant to such paragraph (14).

"(3)(A) No savings and loan holding company shall engage, either de novo or by an acquisition, in whole or in part, of a going concern, in any activity authorized under paragraph (2)(F) of this subsection unless the Corporation has been given sixty days' prior written notice of such proposal and, within such period, the Corporation has not issued an order disapproving the proposal or extending for up to an additional thirty days the period within which such a disapproval may be issued.

"(B) An acquisition may be made prior to the expiration of the disapproval period if the Corporation issues a written notice of its intent not to disapprove the action. The Corporation may provide for no notice under this paragraph or notice for a shorter period of time with respect to particular activities. No notice under this paragraph is required in the event a savings and loan holding company establishes de novo an office to engage in any activity previously authorized for such savings and loan holding company under this paragraph or changes the location of an office engaged in such activity.

"(C) The notice submitted to the Corporation shall contain such information as the Corporation shall prescribe by regulation for the notice or by specific request in connection with a particular notice: *Provided, however,* That the Corporation may only require such information as may be relevant to the nature and scope of the proposed activity and to the Corporation's evaluation of the criteria provided for in subparagraph (D) hereof. In the event the Corporation requires additional relevant information beyond that provided in the notice submitted pursuant to this paragraph, the Corporation may by order suspend the time period provided in subparagraph (A) of this paragraph until it has received such additional relevant information, and the activity that is the subject of the notice may be commenced within thirty days of the date of such receipt unless the Corporation issues a disapproval order as provided in such subparagraph (A). Such suspension order is reviewable under subsection (k) of this section.

"(D) In connection with a notice under this paragraph, the Corporation may consider the following criteria—

"(i) the managerial resources of the companies involved;

"(ii) the adequacy of their financial resources, including their capital, giving consideration to the financial resources and capital of others engaged in similar activities: *Provided*, That the Corporation shall not require a higher level of capital for any activity subject to Federal or State regulation than would be required by an applicable regulatory authority for a company engaged in such activity, unless the Corporation shall find that particular circumstances warrant a higher level of capital;

"(iii) any practice or arrangement that may adversely affect the independence or impartiality of an affiliated insured institution in the provision of credit or other services or the terms on which such credit and services are made available, or the availability of such credit;

"(iv) any material adverse effect on the safety and soundness or financial condition of an affiliated insured institution; and

"(v) with respect to an acquisition subject to paragraph (2) (F) or (G), compliance with such paragraph.

"(E) The Corporation shall by order set forth the reasons for any disapproval under this paragraph. Inaction on any notice or a Corporation order determining not to disapprove a proposal to engage in an activity that has previously been authorized by regulation under this paragraph shall be final and shall not be subject to judicial review under this section or in any other manner: *Provided, however,* That any savings and loan holding company may obtain judicial review pursuant to this section of any Corporation order not to disapprove a notice under this paragraph if such order contains restrictions or conditions.

"(F) The Corporation may by regulation prescribe limitations on the conduct of any activity or activities authorized under paragraph (2)(F) of this subsection other than limitations on activities conducted pursuant to clause (v) thereof, consistent with the criteria in subparagraph (D) hereof and with safe and sound financial practices.

"(G)(i) No savings and loan holding company that owns or controls an insured institution or insured institutions with consolidated deposits in the United States equal to or exceeding 0.30 per centum of all domestic deposits in the United States shall acquire, merge, or consolidate with, or purchase the assets of, a company engaged in insurance, securities, real estate or other activities permissible under paragraph (2)(F) of this paragraph, if immediately after and as a result of such acquisition, such savings and loan holding company shall have an investment in any one such activity that exceeds 25 per centum of the consolidated capital of such savings and loan holding company.

"(ii) No company that is engaged in any activity otherwise permissible for savings and loan holding companies under paragraph (2)(F) of this paragraph shall acquire, merge, or consolidate with, or purchase the assets of, a bank or banks with consolidated deposits in the United States equal to or exceeding 0.30 per centum of all domestic deposits in the United States if, immediately after and as a result of such acquisition, such company shall have an investment in any one such activity that exceeds 25 per centum of the consolidated capital of such company.

"(4)(A) Notwithstanding any other provision of this subsection, any savings and loan holding company (including any subsidiary thereof which is not an insured institution) the sole insured institution subsidiary of which is a qualified thrift lender shall not be subject to the limitations and prohibitions of this subsection: *Provided, however,* That nothing in this paragraph shall exempt a bank holding company or its subsidiaries or affiliates from the provisions of the Bank Holding Company Act.

"(B) A qualified thrift lender is any insured institution that, as determined by the Corporation—

"(i) has an aggregate of not more than 25 per centum of its assets (including loans made by any subsidiary of such institution) invested in commercial loans, nonresidential real estate loans, tangible personal property leased for commercial purposes, and floorplanning or inventory loans, and does not thereafter exceed such percentage on an average basis in three out of every four quarters and two out of every three years; or

"(ii) has an aggregate of not less than 60 per centum of its assets (including investments made by any subsidiary of such an institution) invested in loans, equity positions or securities related to domestic residential real estate or manufactured housing and property used by an institution in the conduct of its business, and does not thereafter fall below such percentage on an average basis in three out of every four quarters and two out of every three years.

"(C) Any insured institution that fails to maintain its status as a qualified thrift lender, as determined by the Corporation, may not thereafter be a qualified thrift lender for a period of 5 years. For good cause shown, the Corporation may allow any company that controls such an institution, up to three years ~~to~~ comply with the investment and activities restrictions contained in this subsection.

"(D) The Corporation may issue such rules or regulations, and conduct such examinations, as it determines to be necessary to carry out the provisions of this paragraph, and may enforce with respect to any qualified thrift lender: *Provided,* That with respect to a stock savings bank insured by the Federal Deposit Insurance Corporation, the Corporation shall rely to the maximum extent possible on examinations conducted by that agency.".

(c) Section 408(d) of the National Housing Act (12 U.S.C. 1730a(d)) is hereby amended as follows:

(1) The introductory phrase is amended to read as follows:

"(d)(1) Except as otherwise provided in this section, no subsidiary insured institution of a savings and loan holding company shall—";

(2) Numbers (1), (2), (3), (4), (5), and (6) shall be redesignated as (A), (B), (C), (D), (E), and (F), respectively, and letters (A), (B), and (C) shall be redesignated as (i), (ii), and (iii); and

(3) The following subsection (d)(2) shall be added at the end thereof:

"(2) The prohibitions of subsection (d)(1) shall not apply to the transactions of any subsidiary insured institution of a savings and loan holding company with an affiliate engaged in the business activites specified in subparagraphs (F) and (G) or subsection (c)(2) of this section except for clause (ii) of subparagraph (F); unless the context otherwise requires, such transactions by an insured institution shall be subject to the same limitations and prohibitions specified in sections 23A and 23B of the Federal Reserve Act (12 U.S.C. 371 c and d) as if such insured institution were a member bank. The Corporation may prescribe rules or regulations for purposes of defining and clarifying the applicability of the limitations and prohibitions described in the preceding sentence.".

"(d) Section 408 (e) of the National Housing Act (12 U.S.C. 1730a(e)) is amended by striking out clause (ii) of subparagraph (1)(B) and inserting in lieu thereof the following:

"(ii) acquired in connection with a reorganization in which a person or group of persons exchange their shares of an insured institution for shares of a newly formed holding company and receive, after such reorganization, substantially the same proportional share interest in the holding company as they held in the insured institution, except for changes in shareholder interests resulting from the exercise of dissenting shareholder rights under State law.".

"(e) Section 408(n) of the National Housing Act (12 U.S.C. 1730a) is amended to read as follows:

"(n) No State shall prohibit the affiliation of an association, as that term is defined in section 2 of the Home Owners' Loan Act of 1933, with a company engaged solely in one or more of the activities described in subparagraphs (F) and (G) of subsection (c)(2) of this section.".

AMENDMENTS TO THE HOME OWNERS' LOAN ACT OF 1933

SEC. 109. (a) Section 5(c) of the Home Owners' Loan Act of 1933 (12 U.S.C. 1464(c)) is amended by amending subparagraph (B) of paragraph (4) to read as follows:

"(B) SERVICE CORPORATIONS.—Investments in any 'depository institution service corporation', as that term is defined in the Depository Institution Service Corporation Act (12 U.S.C. 1861, et seq.) and in accordance with the requirements, conditions, and limitations specified in that Act: *Provided,* That any association that is a qualified thrift lender, as defined in section 408 of the Natonal Housing Act, may make investments in capital stock, obligations, or other securities of any corporation organized under the laws of the State in which the home office of the association is located, if the entire capital stock of such corporation is available for purchase only by savings and loan associations of such State and by Federal associations having their home offices in such State, but no association may make any investment under this subparagraph if its aggregate outstanding investment under this subparagraph would exceed 3 per centum of the assets of the association, except that not less than one-half of the investment permitted under this subparagraph which exceeds 1 per centum of assets shall be used primarily for community, inner city, and community developent purposes.".

(b) Section 5(q) of the Home Owners' Loan Act of 1933 (12 U.S.C. 1464(q)) is amended by adding at the end thereof the following:

"(6) Any action for injunctive relief that may be commenced by any person pursuant to paragraph (2) of this provision, may be commenced on the behalf of such person by any trade association of which such person is a member: *Pro-*

vided, That any such action commenced by a trade association shall be subject to the same requirements, limitations and conditions as would be applicable had such action been commenced by any such person pursuant to paragraph (2) of this provision."

BANK SERVICE CORPORATION ACT

SEC. 110. The Bank Service Corporation Act (12 U.S.C. 1861 et seq.) is amended to read as follows:

"SHORT TITLE AND DEFINITIONS

"SECTION 1. (a) This Act may be cited as the Depository Institution Service Corporation Act.

"(b) For purposes of this Act—

"(1) the term 'appropriate Federal supervisory agency' shall include 'appropriate Federal banking agency' as defined in section 1813(q) of this title (12 U.S.C. 1813(q)) and the Federal Home Loan Bank Board with respect to any 'insured institution' as defined in section 1730a(a)(1)(A) of this title (12 U.S.C. 1730a(a)(1)(A)) other than a qualified thrift lender as defined in section 408 of the National Housing Act;

"(2) the term 'Depository Institution Service Corporation' means a corporation organized to perform services authorized by this Act, all of the capital stock of which is owned by one or more depository institutions;

"(3) the term 'depository institution' means any institution subject to examination and supervision by any 'appropriate Federal supervisory agency';

"(4) the term 'invest' includes any advance of funds to a Depository Institution Service Corporation, whether by the purchase of stock, the making of a loan, or otherwise, except a payment for rent earned, goods sold and delivered, or services rendered prior to the making of such payment; and

"(5) the term 'principal investor' means the depository institution that has the largest dollar amount invested in the capital stock of a Depository Institution Service Corporation. In any case where two or more depository institutions have equal dollar amounts invested in a Depository Institution Service Corporation, the corporation shall, prior to commencing operations, select one of the depository institutions as its principal investor and shall notify the depository institution's appropriate Federal supervisory agency of that choice within five business days of its selection.

"AMOUNT OF INVESTMENT IN DEPOSITORY INSTITUTION SERVICE CORPORATION

"SEC. 2. Notwithstanding any limitation or prohibition otherwise imposed by any provision of law exclusively relating to any depository institution, a depository institution may invest not more than 10 per centum of paid-in and unimpaired capital and unimpaired surplus in Depository Institution Service Corporations. No depository institution shall invest more than 5 per centum of its total assets in Depository Institution Service Corporations.

"PERMISSIBLE DEPOSITORY INSTITUTION SERVICE CORPORATION ACTIVITIES FOR DEPOSITORY INSTITUTIONS

"SEC. 3. A depository institution may invest in one or more Depository Institution Service Corporations that perform, and a Depository Institution Service Corporation may perform, the following services only for depository institutions and credit unions: check and deposit sorting and posting; computation and posting of interest and other credits and charges; preparation and mailing of checks, statements, notices and similar items; credit information, appraising, construction loan inspection, and abstracting; developing and administering personnel benefit programs; research, studies, and surveys; purchasing office supplies, furniture and equipment; developing and operating storage facilities for microfilm or other duplicate records; and clerical, bookkeeping, accounting, statistical, data processing, internal auditing, and similar functions performed for a depository institution.

"SERVICES TO NONSTOCKHOLDERS

"SEC. 4. No Depository Institution Service Corporation shall unreasonably discriminate in the provision of any services authorized under this Act to any depository institution that does not own stock in the service corporation on the basis of the fact that the nonstockholding institution is in competition with an institution service that owns stock in the depository institution corporation, except that—

"(1) it shall not be considered unreasonable discrimination for a Depository Institution Service Corporation to provide services to a nonstockholding institution only at a price that fully reflects all of the costs of offering those services, including the cost of capital and a reasonable return thereon; and

"(2) a Depository Institution Service Corporation may refuse to provide services to a nonstockholding institution if comparable services are available from another source at competitive overall costs, or if the providing of services would be beyond the practical capacity of the service corporation.

"REGULATION AND EXAMINATION OF DEPOSITORY INSTITUTION SERVICE CORPORATIONS

"SEC. 5. (a) A Depository Institution Service Corporation shall be subject to examination and regulation by the appropriate Federal supervisory agency of its principal investor to the same extent as its principal investor. The appropriate Federal supervisory agency of the principal shareholder of such a Depository Institution Service Corporation may authorize any other Federal supervisory agency that supervises any other shareholder of the Depository Institution Service Corporation to make such an examination.

"(b) A Depository Institution Service Corporation shall be subject to the provisions of the Financial Institutions Supervisory Act of 1966 as if such service corporation were the same type of depository institution as its principal investor, except that the appropriate Federal supervisory agency of the principal investor shall be authorized to apply such provisions to a Depository Institution Service Corporation.

"(c) Notwithstanding subsection (a) of this section, whenever a depository institution that is regularly examined by an appropriate Federal supervisory agency, or any subsidiary or affiliate of such a depository institution that is subject to examination by that agency, causes to be performed for itself, by contract or otherwise, any services authorized under this Act, whether on or off its premises—

"(1) such performance shall be subject to regulation and examination by such agency to the same extent as if such services were being performed by the depository institution itself on its own premises, and

"(2) the depository institution shall notify such agency of the existence of the service relationship within thirty days after the making of such service contract or the performance of the service, whichever occurs first.

"(d) The appropriate Federal supervisory agencies are authorized to issue such regulations and orders as may be necessary to enable them to administer and to carry out the purposes of this Act and to prevent evasions thereof.

"GRANDFATHER RIGHTS

"SEC. 6. (a) Notwithstanding any other provision of law—

"(1) any service corporation owned by one or more depository institutions and acquired or maintained and operated pursuant to the Bank Service Corporation Act of 1982 (12 U.S.C. 1861 et seq. (1982, repealed 1983)) or pursuant to subparagraph (B)(4) of section 5(c) of the Home Owners' Loan Act of 1933 (12 U.S.C. 1464(c)(B)(4)) and any regulations promulgated thereunder, may engage in those activities in which (i) it was lawfully engaged on July 1, 1983, and (ii) it has been engaged continuously since July 1, 1983; and

"(2) any depository institution that (i) lawfully invested in a service corporation within the meaning of paragraph (1) of this subsection as of July 1, 1983, and (ii) continuously maintained an investment in such a service corporation since July 1, 1983, may maintain and increase such investment, provided that any such investment is made and maintained in accordance with all conditions, requirements, and limitations applicable thereto under the laws described in paragraph (1) of this subsection.

"(b) The authority conferred by subsection (a) of this section shall terminate, with respect to any covered service corporation, at such time as such service corporation expands its activities to include any new activity, or, with respect to any covered depository institution with an investment in such a service corporation, at such time as such depository institution invests in excess of the limitations set forth in subsection (a)(2) of this section in any service corporation: *Provided*, That any appropriate Federal supervisory agency may, upon application by a service corporation or depository institution that would be required to terminate activities of or divest stockownership in a service corporation, authorize such service corporation or depository institution to maintain its activities or stock interest for an appropriate period of time in the public interest, but in no event shall such time period exceed one year.

"MUTUAL THRIFT SERVICE CORPORATIONS

"SEC. 7. Notwithstanding any other provision of law, any association, which is organized and continues to operate in the mutual form, is authorized to invest in the capital stock, obligations, or other securities of any corporation organized under the laws of the State in which the home office of the mutual organization is located, if the entire capital stock of such corporation is available for purchase only by savings and loan associations of such State and by Federal associations having their home offices in such State, but no mutual organization may make any investment under this section if its aggregate outstanding investment under this section would exceed 3 per centum of the assets of the mutual organization, except that not less than one-half of the investment permitted under this section shall be used primarily for community, inner city, and community development purposes. This section shall be interpreted under the Home Owners' Loan Act of 1933, and regulations lawfully promulgated thereunder as of July 1, 1983.".

TITLE II—CREDIT UNION AMENDMENTS

SECOND MORTGAGE LOANS

SEC. 201. Section 107(5)(A)(ii) of the Federal Credit Union Act (12 U.S.C. 1757(5)(A)(ii)) is amended by inserting after "maturity not to exceed fifteen years" the following: "or any longer term which the Board may choose to allow".

MEMBERSHIP SHARES

SEC. 202. Section 107(6) of the Federal Credit Union Act (12 U.S.C. 1757)(6)) is amended to read as follows:

"(6) to receive from its members, from other credit unions, from an officer, employee, or agent of those nonmember units of Federal, Indian, Tribal, State, or local governments and political subdivisions thereof enumerated in section 207 of this Act and in the manner so prescribed, from the Central Liquidity Facility, and from nonmembers in the case of low-income members (as defined by the Board) funds for credit deposit accounts and payments on (A) shares which may be issued at varying dividend rates; (B) share certificates which may be issued at varying dividend rates and maturities; (C) share draft accounts authorized under section 205(f); and (D) membership shares; subject to such terms, rates, and conditions as may be established by the board of directors, within limitations prescribed by the Board.".

FAITHFUL PERFORMANCE

SEC. 203. Section 112 of the Federal Credit Union Act (12 U.S.C. 1761a) is amended by striking out the third sentence and inserting in lieu thereof the following: "The board shall elect from their number a financial officer who shall give adequate fidelity coverage in accordance with section 122 of this Act.".

MEMBERSHIP OFFICER

SEC. 204. Section 113 of the Federal Credit Union Act (12 U.S.C. 1761b) is amended by striking out "of the board of directors" in paragraph (1) and inserting in lieu thereof "of the credit union.".

POWERS OF THE BOARD OF DIRECTORS

SEC. 205. Section 113 of the Federal Credit Union Act (12 U.S.C. 1761b) is amended—

(1) by striking out paragraph (2) and inserting in lieu thereof the following:

"(2) provide adequate fidelity coverage for officers and employees having custody of or handling funds according to regulations issued by the Board;";

(2) by striking out paragraph (7) and inserting in lieu thereof the following:

"(7) determine whether a membership share will be established, the maximum number of shares, share certificates, and share draft accounts and the classes of shares, share certificates, and share draft accounts;";

(5) by striking out paragraph (11) and inserting in lieu thereof the following:

"(11) establish the par value of the membership share (if any) and the share;" and

(6) by striking out paragraph (18) and inserting in lieu thereof the following:

"(18) declare the dividend rate to be paid on shares, share certificates, share draft accounts, and membership shares pursuant to the terms and conditions of section 117;".

NONPARTICIPATION IN THE CREDIT UNION

SEC. 206. Section 118 of the Federal Credit Union Act (12 U.S.C. 1764) is amended—

(1) by striking out "subject to" in subsection (a) and inserting in lieu thereof "except as provided in"; and

(2) by inserting "and enforce" after "adopt" in Subsection (b).

CHANGE IN INSURANCE STATUS

SEC. 207. Section 206(d)(2) of the Federal Credit Union Act (12 U.S.C. 1786(d)(2)) is amended to read as follows:

"(2) No credit union shall convert from status as an insured credit union under this Act as provided under subsection (a)(2) of this section until the proposition for such conversion has been approved by a majority of all the directors of the credit union and by affirmative vote of a majority of the members of the credit union who vote on the proposition. Following approval by the directors, written notice of the proposition and of the date set for the membership vote shall be delivered in person to each member, or mailed to each member at the address for such member appearing on the records of the credit union, not more than thirty nor less than seven days prior to such date. The written notice of the proposition shall in boldface type state that the issue will be decided by a majority of the members who vote. The membership shall be given the opportunity to vote by mail ballot. If the proposition is approved by the membership, prompt and reasonable notice of insurance conversion shall be given to all members.".

TITLE III—BANKERS BANKS

AMENDMENT TO SECTION 5136 OF THE REVISED STATUTES

SEC. 301. The paragraph numbered "Seventh" of section 5136 of the Revised Statutes (12 U.S.C. 24 (Seventh)) is amended by striking out "*Provided further,* That" and all that follows through the end thereof and inserting in lieu thereof the following: "*Provided further,* That notwithstanding any other provision of this paragraph, the association may purchase for its own account shares of stock of a bank or a holding company which owns or controls such a bank if (1) the stock of such bank or company is owned exclusively (except to the extent directors' qualifying shares are required by law) by depository institutions, and (2) such bank or company and all subsidiaries thereof are engaged exclusively in providing services for depository institutions, their parent holding companies, subsidiaries thereof, and the officers, directors, and employees of each. In no event shall the total amount of stock held by the association in any bank or holding company described in the immediately preceding proviso exceed at any time 10 per centum of the association's capital stock and paid-in and unimpaired surplus and in no event shall the purchase of such stock result in an association's acquiring more than 5 per centum of any class of voting securities of such bank or company.".

AMENDMENT TO SECTION 5169 OF THE REVISED STATUTES

SEC. 302. Section 5169(b)(1) of the Revised Statutes (12 U.S.C. 27(b)(1)) is amended to read as follows:

"(b)(1) The Comptroller of the Currency may also issue a certificate of authority to commence the business of banking pursuant to this section to a national banking association if (A) such association or its parent holding company is owned exclusively (except to the extent directors' qualifying shares are required by law) by depository institutions, and (B) the association, its parent holding company, and all subsidiaries thereof are organized to engage exclusively in providing services for depository institutions, their parent holding companies, subsidiaries thereof, and the officers, directors, and employees of each.".

AMENDMENTS TO THE DEPOSITORY INSTITUTION MANAGEMENT INTERLOCKS ACT

SEC. 303. (a) Section 202(3) of the Depository Institution Management Interlocks Act (12 U.S.C. 3201(3)) is amended—

(1) by striking out "; or" after paragraph (C) and inserting in lieu thereof a period; and

(2) by striking out paragraphs (D) and (E).

(b) Section 205(6) of the Depository Institution Management Interlocks Act (12 U.S.C. 3204(6)) is amended to read as follows:

"(6) A Federal Home Loan Bank or any bank or the parent holding company thereof organized specifically to serve depository institutions, their parent holding companies, subsidiaries thereof, and the officers, directors, and employees of each.".

AMENDMENTS TO THE BANK HOLDING COMPANY ACT OF 1956

SEC. 304. (a) Section 2(c) of the Bank Holding Company Act of 1956 (12 U.S.C. 1841(c)) is amended by inserting after the first sentence thereof the following: "The term 'bank' also includes a State chartered bank or a national banking association if (1) such bank or its parent holding company is owned exclusively (except to the extent directors' qualifying shares are required by law) by depository institutions, and (2) such bank, its parent holding company, and all subsidiaries thereof are organized to engage exclusively in providing services for depository institutions, their parent holding companies, subsidiaries thereof, and the officers, directors, and employees of each.".

(b) Section 4(c)(14)(F) of the Bank Holding Company Act of 1956 (12 U.S.C. 1843(c)(14)(F)) is amended—

(1) by striking the period after clause (i) and inserting in lieu thereof a semicolon;

(2) by inserting "and" after clause (ii);

(3) by striking out clause (iii) and inserting in lieu thereof the following:

"(iii) notwithstanding any other provision of law, the term 'bank holding company' shall include a bank if (1) such bank or its parent holding company is owned primarily by depository institutions, and (2) such bank, its parent holding company, and all subsidiaries thereof are organized to engage exclusively (except as provided in this paragraph) in providing services for depository institutions, their parent holding companies, subsidiaries thereof, and the officers, directors, and employees of each. No depository institution, owning stock in a bank or a holding company described in this clause which invests in an export trading company, shall extend credit to an export trading company in an amount exceeding at any one time 10 per centum of such depository institution's capital and surplus."; and

(4) by striking out clause (iv).

TITLE IV—COMPETITIVE SAVINGS INCENTIVE

SHORT TITLE

SEC. 401. This title shall be referred to as the "Competitive Savings Incentive Act of 1983".

MONEY MARKET DEPOSIT ACCOUNTS

SEC. 402. Section 19(c) of the Federal Reserve Act (12 U.S.C. 461) is amended by adding at the end thereof the following new paragraph:

"(3) Notwithstanding any other provision of law, reserves held by—

"(A) any bank, savings and loan association or mutual or stock savings bank against accounts authorized by section 327 of the Garn-St Germain Depository Institutions Act of 1982 and regulations promulgated thereunder or transaction accounts authorized after December 1, 1982, pursuant to section 327 of the Garn-St Germain Depository Institutions Act of 1982 or sections 203 and 204 of the Depository Institutions Deregulation and Monetary Control Act of 1980 (12 U.S.C. 3502 and 3503); or

"(B) any insured credit union against any comparable accounts authorized by section 117 of title I of the Federal Credit Union Act (12 U.S.C. 1763) and regulations promulgated thereunder,

may be in the form of vault cash, or as deposits in an Earnings Participation Account at a Federal Reserve Bank which shall receive earnings to be paid each month at the rate earned on the securities portfolio of the Federal Reserve System during that month. The earnings on such portfolio shall be passed through on a prorated basis to the depository institutions which maintain reserves pursuant to this paragraph. The Board may prescribe rules and regulations concerning the maintenance and administration of Earnings Participation Accounts under this paragraph.".

TITLE V—CONSUMER LEASES AND RENTAL-PURCHASE AGREEMENTS

SHORT TITLE

SEC. 501. This title may be cited as the "Consumer Lease and Rental-Purchase Agreement Act".

AMENDMENT TO THE CONSUMER CREDIT PROTECTION ACT

SEC. 502. The Consumer Credit Protection Act is amended by adding at the end thereof the following new title:

"TITLE X—CONSUMER LEASE AND RENTAL-PURCHASE ACT

"Chap. Sec.
"1. General Provisions........ 101
"2. Consumer Leases and Rental-Purchase Agreements........ 111
"3. Enforcement and Liability........ 121
"4. Miscellaneous........ 131

"CHAPTER 1—GENERAL PROVISIONS

"Sec.
"101. Short title.
"102. Findings and declaration of purpose.
"103. Definitions and rules of construction.
"104. Exempted transactions.
"105. Regulations.

"CHAPTER 2—CONSUMER LEASES AND RENTAL-PURCHASE AGREEMENTS

"Sec.
"111. General requirements of disclosure.
"112. Consumer lease disclosures.
"113. Consumer's liability at early termination or at the end of the lease term.
"114. Rental-purchase disclosures.
"115. Renegotiations and extensions.
"116. Consumer lease advertising.
"117. Rental-purchase advertising.

"CHAPTER 3—ENFORCEMENT AND LIABILITY

"Sec.
"121. Administrative enforcement.
"122. Civil liability.
"123. Defenses.
"124. Liability of assignees.
"125. Criminal liability.

"CHAPTER 4—MISCELLANEOUS

"Sec.
"131. Relation to State laws.
"132. Effect on governmental agencies.
"133. Reports by Board and Attorney General.
"134. Effective date.

"TITLE X—CONSUMER LEASE AND RENTAL-PURCHASE ACT

"CHAPTER 1—GENERAL PROVISIONS

"§ 101. Short title

"This title may be cited as the 'Consumer Lease and Rental-Purchase Act'.

"§ 102. Findings and declaration of purpose

"(a) The Congress finds that the leasing of consumer goods continues to be a popular alternative to installment credit purchases. It is the purpose of this title to assure a more meaningful disclosure of the terms of leases of personal property for personal, family or household purposes, permitting the consumer to compare more readily the various lease terms available; to limit the potential balloon payment in consumer leases to a reasonable amount; and to assure accurate disclosures of lease terms in advertising.

"(b) The Congress also finds that a significant number of consumers have begun to acquire ownership of personal property through rental-purchase agreements. These rental-purchase agreements have been offered without adequate cost disclosures. It is the purpose of this statute to assure meaningful disclosure of the terms of rental-purchase agreements; to make the consumer aware of the total cost of the agreement; to inform the consumer when ownership will transfer; and to assure accurate disclosures of rental terms in advertising.

"§ 103. Definitions and rules of construction

"(a) The following definitions apply to this title:

"(1) 'Advertisement' means a commercial message in any medium that aids, promotes, or assists directly or indirectly a consumer lease or a rental-purchase agreement.

"(2) 'Agricultural purposes' includes the production, harvest, exhibition, marketing, transportation, processing, and manufacture of agricultural products by a natural person who cultivates, plants, propagates, or nurtures those agricultural products, including but no limited to the acquisition of farmlands, real property with a farm residence, and personal property and services used primarily in farming.

"(3) 'Board' refers to the Board of Governors of the Federal Reserve System.

"(4) 'Consumer' means a natural person who leases personal property under a consumer lease or rents personal property under a rental-purchase agreement.

"(5) 'Consumer lease' means a contract in the form of a lease or bailment for the use of personal property, and the purchase of services incidental thereto, by a natural person primarily for personal, family, or household purposes, for a period exceeding four months, in which the total lease cost is not more than $25,000, whether or not the consumer has the option to purchase or otherwise become the owner of the property at the expiration of the lease. The term does not include any 'credit sale' as defined in title I.

"(6) 'Consummation' means the time a consumer becomes contractually obligated on a consumer lease or rental-purchase agreement.

"(7) 'Lessor' means a person who regularly provides the use of property through consumer leases or rental-purchase agreements and to whom the obligation is initially payable on the face of the lease or rental-purchase agreement.

"(8) 'Personal property' means any property that is not real property under the laws of the State where it is located when it is made available for a consumer lease or a rental-purchase agreement.

"(9) 'Rental-purchase agreement' means an agreement for the use of personal property by a natural person primarily for personal, family, or household purposes, for an initial perod of four months or less (whether or not there is any obligation beyond the initial period) that is automatically renewable with each payment and that permits the consumer to become the owner of the property. The term does not include any 'credit sale' as defined in title I.

"(10) 'Residual value' means the wholesale or retail fair market value of the leased property at early termination or the end of the lease term in a consumer lease.

"(11) 'State' refers to any State, the Commonwealth of Puerto Rico, the District of Columbia, and any territory or possession of the United States.

"(b) Unless the context indicates otherwise, the term 'lease' means consumer lease, and the term 'agreement' means rental-purchase agreement.

"(c) Any reference to any provisions of this title includes reference to the regulations of the Board under this title.

"§ 104. Exempted transactions

"This title does not apply to the following:

"(1) Consumer leases and rental-purchase agreements primarily for business, commercial, or agricultural purposes, or those made with government agencies or instrumentalities or with organizations.

"(2) A lease of a safe deposit box.

"(3) A lease or bailment of personal property which is incidental to the lease of real property, and which provides that the consumer has no liability for the value of the property at scheduled expiration except for abnormal wear and tear and that the consumer has no option to purchase the leased property.

"§ 105. Regulations

"(a) The Board shall write regulations to carry out the purposes of this title, to prevent its circumvention, and to facilitate compliance with its requirements. The regulations may contain classifications and differentiations and may provide for adjustments and exceptions for any class of transaction.

"(b) The Board shall publish model disclosure forms and clauses to facilitate compliance with the disclosure requirements and to aid the consumer in understanding the transaction. In designing forms, the Board shall consider the use by lessors of data processing or similar automated equipment. Use of the models shall be optional. A lessor who properly uses the models shall be deemed to be in compliance with the disclosure requirements.

"(c) Any regulation of the Board, or any amendment or interpretation thereof, that requires a disclosure different from the disclosures previously required shall have an effective date of October 1 that follows the date of promulgation by at least six months. The Board may at its discretion lengthen that period of time to permit lessors to adjust their forms to accommodate new requirements. The Board may also shorten that period of time if it makes a specific finding that such action is necessary to comply with the findings of a court or to prevent unfair or deceptive practices. In any case, lessors may comply with any newly promulgated disclosure requirement prior to its effective date.

"CHAPTER 2—CONSUMER LEASES AND RENTAL-PURCHASE AGREEMENTS

"§ 111. General requirements of disclosure

"(a) The lessor shall disclose to the consumer the information required by this title. In a transaction involving more than one consumer, a lessor need disclose to only one of the consumers who are primarily obligated. In a transaction involving more than one lessor, only one lessor need make the disclosures.

"(b) The disclosures shall be made at or before consummation of the consumer lease or rental-purchase agreement.

"(c) The disclosures shall be made clearly and conspicuously in writing, in a form that the consumer may keep. The disclosures required under sections 112 and 114 shall be segregated from all other terms, data, or information provided.

"(d) Information required to be disclosed may be given in the form of estimates and identified as such when the lessor does not know the exact information.

"(e) If a disclosure becomes inaccurate as the result of any act, occurrence, or agreement after delivery of the required disclosures, the resulting inaccuracy is not a violation of this title.

"§ 112. Consumer lease disclosures

"For each consumer lease, the lessor shall disclose the following items, as applicable:

"(1) The total of initial payments required at or before consummation of the lease or delivery of the property, whichever is later.

"(2) The number, amounts, and timing of scheduled payments.

"(3) The total of scheduled payments.

"(4) The total of amounts payable at the expiration of the lease (not including any difference between the anticipated residual value and the actual residual value).

"(5) The total lease cost, which is the sum of items (1), (3), and (4).

"(6) The amount of any required security deposit.

"(7) When the consumer buys required insurance from or through the lessor, the total cost. When the consumer does not buy required insurance from or through the lessor, a statement that the consumer must buy insurance and that the cost is not included in the numerical disclosures.

"(8) When any official fees and taxes are paid to or through the lessor, the total cost. When any official fees or taxes are not paid to or through the lessor, a statement that the consumer must pay official fees or taxes and that the amounts are not included in the numerical disclosures.

"(9) Any dollar charge or percentage amount that may be imposed for a late payment, other than a deferral or extension charge.

"(10) A statement that the consumer may be liable for additional amounts if the lease is terminated early.

"(11) When the consumer's liability is based on the residual value of the property, a statement that the consumer may have the property appraised at the consumer's expense by an independent third party agreed to by the consumer and lessor, and that the parties will be bound by the appraisal.

"(12) When the consumer's liability at the end of the lease term is based on the anticipated residual value of the property:

"(A) The anticipated residual value of the property, marked as wholesale or retail;

"(B) A brief statement of the consumer's potential liability at the end of the lease term;

"(C) The product of three times the average payment allocable to a month; and

"(D) A statement that the consumer's liability will generally be limited to item (12)(C) unless the excess is a result of excessive use or unreasonable wear and use, or the lessor brings a successful court action proving that the estimate of the anticipated residual value was reasonable.

"(13) A statement that the consumer may have other costs and that the consumer should refer to the appropriate lease document for information about nonpayment and default, wear and use standards, and maintenance responsibility.

"§ 113. Consumer's liability at early termination or at the end of the lease term

"(a) When the consumer's liability at the end of the lease term is based on the anticipated residual value of the leased property, the anticipated residual value shall be a reasonable estimate of the actual residual value of the property at the end of the lease term. There shall be a rebuttable presumption that the anticipated residual value is unreasonable to the extent that it exceeds the actual residual value at the end of the lease term by more than three times the average payment allocable to a month. The lessor shall not collect any amount in excess of three times the average payment allocable to a month unless the lessor brings a successful action in court providing that the estimate was reasonable. If the lessor fails to rebut the presumption, the lessor must pay the costs of the action and the consumer's reasonable attorney's fees.

"(b) The presumption in subsection (a) shall not apply to the extent that the excess of the anticipated residual value over the actual residual value is due to damage to the property beyond reasonable wear and use or to excessive use. The lessor may set reasonable standards for wear and use in the lease.

"(c) Subsection (a) does not preclude the right of a willing consumer and lessor to make a mutually agreeable final adjustment with respect to the excess of three times the average payment allocable to a month, provided the agreement is made after the end of the lease term.

"(d) In the lease the lessor may specify penalties or other charges for delinquency, default, or early termination, if the amounts are reasonable in light of the anticipated or actual harm caused by the delinquency, default, or early termination, the difficulties of proof of loss, and the inconvenience or nonfeasibility of otherwise obtaining an adequate remedy.

"(e) When the consumer's liability is based on the residual value of the leased property, the consumer may obtain at the consumer's expense a professional appraisal of the property by an independent third party agreed to by both parties. This appraisal shall be binding on the parties.

"§ 114. Rental-purchase disciosures

"For each rental-purchase agreement, the lessor shall disclose the following items, as applicable:

"(1) The number, amounts and timing of all payments necessary to acquire ownership of the property.

"(2) The number of payments and the total of payments necessary to acquire ownership of the property.

"(3) A statement that the consumer will not own the property until the consumer has made the number of payments and the total of payments necessary to acquire ownership.

"(4) A statement that the total of payments does not include other charges, such as late payment, default, pickup, and reinstatement fees, and that the consumer should see the contract for an explanation of these charges.

"(5) A statement that the consumer is responsible for the fair market value of the property if it is lost, stolen, damaged, or destroyed.

"(6) A statement indicating whether the property is new or used.

"§ 115. Renegotiations and extensions

"(a) A renegotiation occurs when an existing consumer lease or rental-purchase agreement is satisfied and replaced by a new lease or agreement undertaken by the same lessor and consumer. A renegotiation is a new lease or agreement requiring new disclosures. However, events such as the following shall not be treated as renegotiations:

"(1) The addition or return of property in a multiple-item lease or agreement or the substitution of the leased property, if in either case the average payment allocable to a payment period is not changed by more than 25 per centum.

"(2) A deferral or extension of one or more periodic payments, or portions of a periodic payment.

"(3) A reduction in charges in the lease or agreement.

"(4) A lease or agreement involving a court proceeding.

"(5) Any other event described in regulations prescribed by the Board.

"(b) No disclosures are required for any extension of a consumer lease or a rental-purchase agreement. However, a lessor that extends or permits a consumer to extend a consumer lease for more than one month beyond the end of the lease term shall (for purposes of section 113) recalculate the anticipated residual value of the leased property to reflect the depreciation resulting from the extended term.

"§ 116. Consumer lease advertising

"(a) If an advertisement for a consumer lease states the amount of any payment or states that any or no initial payment is required, the advertisement must also clearly and conspicuously state the following items, as applicable:

"(1) That the transaction advertised is a lease.

"(2) The total of initial payments required at or before consummation of the lease or delivery of the property, whichever is later.

"(3) That a security deposit is required.

"(4) The number, amounts, and timing of scheduled payments.

"(5) For a lease in which the consumer's liability at the end of the lease term is based on the anticipated residual value of the property, that an extra charge may be imposed at the end of the lease term.

"(b) Any owner or personnel of any medium in which an advertisement appears or through which it is disseminated shall not be liable under this section.

"§ 117. Rental-purchase advertising

"(a) If an advertisement for a rental-purchase agreement refers to or states the amount of any payment or the right to acquire ownership, the advertisement must also clearly and conspicuously state the following items, as applicable:

"(1) That the transaction advertised is a rental-purchase agreement.

"(2) The total of payments necessary to acquire ownership.

"(3) That the consumer acquires no ownership rights if the total amount necessary to acquire ownership is not paid.

"(b) Any owner or personnel of any medium in which an advertisement appears or through which it is disseminated shall not be liable under this section.

"CHAPTER 3—ENFORCEMENT AND LIABILITY

"§ 121. Administrative enforcement

"(a) Compliance with the requirements imposed by this title shall be enforced under—

"(1) section 8 of the Federal Deposit Insurance Act, in the case of—

"(A) national banks, by the Comptroller of the Currency;

"(B) member banks of the Federal Reserve System (other than national banks), by the Board; and

"(C) banks insured by the Federal Deposit Insurance Corporation (other than members of the Federal Reserve System), by the Board of Directors of the Federal Deposit Insurance Corporation; and

"(2) section 5(d) of the Home Owners' Loan Act of 1933, section 407 of the National Housing Act, and sections 6(i) and 17 of the Federal Home Loan Bank

Act, by the Federal Home Loan Bank Board (acting directly or through the Federal Savings and Loan Insurance Corporation), in the case of any institution subject to any of those provisions;

"(3) the Federal Credit Union Act, by the National Credit Union Administration with respect to any Federal credit union;

"(4) the Packers and Stockyards Act, 1921 (except as provided in sections 406 of that Act), by the Secretary of Agriculture with respect to any activities subject to that Act; and

"(5) the Farm Credit Act of 1971, by the Farm Credit Administration with respect to any Federal land bank, Federal land bank association, Federal intermediate credit bank, or production credit association.

"(b) For the purpose of the exercise by any agency referred to in subsection (a) of its powers under any Act referred to, a violation of a requirement imposed by this title shall be deemed to be a violation of a requirement imposed under that Act. In addition to its powers under any provision of law specifically referred to in subsection (a), each agency may exercise any other authority conferred on it by law in enforcing any requirement imposed under this title.

"(c) Except to the extent that enforcement of the requirements imposed by this title is specifically committed to some other agency under subsection (a), the Federal Trade Commission shall enforce the requirements. For the purpose of exercising its functions and powers under the Federal Trade Commission Act, a violation of any requirement imposed by this title shall be deemed a violation of a requirement imposed under that Act. All of the functions and powers of the Federal Trade Commission under the Federal Trade Commission Act are available to the Commission to enforce compliance by any person with the requirements imposed by this title, whether or not that person is engaged in commerce or meets any other jurisdictional tests in the Federal Trade Commission Act.

"(d) The authority of the Board to issue regulations under this title does not impair the authority of any other agency designated in this section to make rules respecting its own procedures in enforcing compliance with requirements imposed by this title.

"§ 122. Civil liability

"(a) Except as otherwise provided in this title, a lessor who fails to comply with a requirement of sections 111, 112, 113, 114, or 115 with respect to a consumer is liable to the consumer in an amount equal to the sum of—

"(1) actual damages sustained by the consumer as a result of the violation;

"(2) in the case of an individual action relating to a consumer lease, 25 per centum of the total of scheduled payments under the lease, but not less than $100 nor greater than $1,000;

"(3) in the case of an individual action relating to a rental-purchase agreement, 25 per centum of the total of payments necessary to acquire ownership, but not less than $100 nor greater than $1,000;

"(4) In the case of a class action, the amount the court determines to be appropriate with no minimum recovery as to each member. The total recovery in any class action or series of class actions arising out of the same violation may not be more than the lesser of $500,000 or 1 per centum of the net worth of the lessor. In determining the amount of the award in any class action, the court shall consider, among other relevant factors, the amount of actual damages awarded, the frequency and persistence of the violation, the lessor's resources, and the extent to which the lessor's violation was intentional; and

"(5) the costs of the action and reasonable attorney's fees as determined by the court.

"(b) In the case of an advertisement, any lessor who fails to comply with the requirements of sections 116 and 117 with regard to any person is liable to that person for actual damages suffered from the violation, the costs of the action, and reasonable attorney's fees.

"(c) When there are multiple lessors, liability shall be imposed only on the lessor who made the disclosures. When no disclosures have been given, liability shall be imposed on all lessors.

"(d) When there are multiple consumers in a consumer lease or a rental-purchase agreement, there shall be only one recovery of damages under subsection (a) for a violation of this title.

"(e) Multiple violations in connection with a single consumer lease or rental-purchase agreement entitle the consumer to a single recovery under this section.

"(f) An action under this section may be brought in any United States district court or in any other court of competent jurisdiction within one year of the date of the occurrence of the violation, except that in the case of a violation under section 113 an action may be brought within one year of the end of the lease term. This subsection does not bar a consumer from asserting a violation of this title in an action to collect the debt brought more than one year from the date of the occurrence of the violation as a matter of defense by recoupment or setoff, except as otherwise provided by State law.

"(g) A consumer may not take any action to offset any amount for which a lessor is potentially liable under subsection (a) against any amount owed by the consumer, unless the amount of the lessor's liability has been determined by judgment of a court of competent jurisdication in an action in which the lessor was a party. This subsection does not bar a consumer then in default on the obligation from asserting a violation of this title as an original action, or as a defense or counterclaim to an action brought by the lessor to collect amounts owed by the consumer.

"§ 123. Defenses

"(a) A lessor is not liable under sections 121, 122, or 125 for a violation of the requirements of sections 111, 112, and 114 if within sixty days after discovering the error, and before an action under section 122 is filed or written notice of the error is received from the consumer, the lessor notifies the consumer of the error and makes whatever adjustments in the account are necessary to assure that the consumer will not be required to pay an amount in excess of the amounts actually disclosed. This provision applies whether the discovery of the error was made through a final written examination report or the lessor's own procedures.

"(b) A lessor is not liable under section 122 for a violation of this title if the lessor shows by a preponderance of evidence that the violation was not intentional and resulted from a bona fide error even though the lessor maintained procedures reasonably adapted to avoid such error. Examples of a bona fide error include, but are not limited to, clerical, calulation, computer malfunction and programing, and printing errors. An error of legal judgment with respect to the requirements of this title is not a bona fide error.

"(c) A lessor is not liable under this title for any act done or omitted in good faith in conformity with any rule, regulation, interpretation, or approval promulgated by the Board or by an official duly authorized by the Board. This rule applies even if, after the act or omission has occurred, the rule, regulation, interpretation, or approval is amended, rescinded, or determined by judicial or other authority to be invalid for any reason.

"§ 124. Liability of assignees

"(a) For purposes of sections 122 and 123, the term 'lessor' as used in those sections shall include an assignee of the lessor. However, a civil action for a violation of this title may be brought against an assignee only if the violation is apparent on the face of the disclosure statement. A violation apparent on the face of the disclosure statement includes, but is not limited to, a disclosure that can be determined to be incomplete or inaccurate from the face of the disclosure statement or other documents assigned. An assignee has no liability where the assignment is involuntary.

"(b) In an action by or against an assignee, the consumer's written acknowledgement of receipt shall be conclusive proof that the disclosures were made, provided the assignee had no knowledge that disclosures had not been made when the assignee acquired the obligation.

"§ 125. Criminal liability

"A fine of $5,000 or a prison term of not more than one year, or both, may be imposed on anyone who willfully and knowingly fails to comply with any requirement imposed under this title.

"CHAPTER 4—MISCELLANEOUS

"§ 131. Relation to State laws

"(a) This title does not annul, alter, or affect the laws of any State regarding the disclosure of consumer leases or rental-purchase agreements, nor does this title exempt any person subject to the provisions of this title from complying with the laws of any State with respect to consumer leases or rental-purchase agreements, except to the extent those laws are inconsistent with any provision of this title, and then only to the extent of the inconsistency. The laws of a State are inconsistent if a person is unable to comply with them without violating a provision of this title. The Board is authorized to determine whether such inconsistencies exist.

"(b) The Board shall by regulation exempt from the requirements of this title any class of lease transactions and rental-purchase agreements within any State if it determines that the State law contains requirements substantially similar to those imposed by this title or gives greater protection and benefit to the consumer, and that there is adequate provision for enforcement.

"(c) Except as specified in sections 122 and 123, this title does not affect the validity or enforceability of any contract or obligation under State or Federal law.

"(d) Determinations under this section may be requested by any State.

"§ 132. Effect on governmental agencies

"No civil or criminal penalty provided by this title for violations may be imposed on the United States or any of its departments or agencies, any State or political subdivision, or any agency of any State or political subdivision.

"§ 133. Reports by Board and Attorney General

"Each year the Board and the Attorney General shall report to the Congress concerning the administration of their functions under this title, including any recommendations necessary or appropriate. In addition, the Board's report shall include its assessment of the extent to which compliance with the requirements imposed by this title is being achieved.

"§ 134. Effective date

"(a) This title shall take effect on the October 1 that is at least two years after the date of its enactment.

"(b) All regulations, forms, and clauses required to be prescribed shall be promulgated one year prior to such effective date.

"(c) Notwithstanding subsections (a) and (b), any lessor may comply with the requirements of this title, in accordance with the regulations, forms, and clauses prescribed by the Board, prior to such effective date.".

CONFORMING AMENDMENTS

SEC. 503. (a) Section 102 of the Truth in Lending Act is amended by striking out "(a)" before "The Congress" and by striking out subsection (b).

(b) Section 105(b) of such Act is amended by striking out "or lessee", by striking out "or lessors", and by striking out "or lessor" each place it appears.

(c) Section 105(d) of such Act is amended by striking out ", or chapter 5", by striking out "or lessors" each place it appears, and by striking out "or lessor".

(d) Section 121(a) of such Act is amended by striking out "a consumer lease or", and by striking out "or lessor".

(e) Section 121(b) of such Act is amended by striking out "or one lessor as defined in section 181(3)," and by striking out "or lessor" each place it appears.

(f) Section 122(b) of such Act is amended by striking out "or lessor" and by striking out "chapters 4 and 5" and inserting in lieu thereof "chapter 4".

(g) Section 130(a) of such Act is amended by striking out "or 5", by striking out "(i)", by striking out "or (ii) in the case of an individual action relating to a consumer lease under chapter 5 of this title, 25 per centum of the total amount of monthly payments under the lease,", and by striking out "or 5".

(h) Section 130(b) of such Act is amended by striking out "or chapter 5".

(i) Section 130(d) of such Act is amended by striking out "or consumer lease".

(j) Section 130(g) of such Act is amended by striking out "or 5" and by striking out "consumer lease,".

(k) Chapter 5 of title I of the Consumer Credit Protection Act is repealed.

TITLE VI—FAIR DEPOSIT AVAILABILITY

SHORT TITLE

Sec. 601. This title may be cited as the "Fair Deposit Availability Act of 1983".

DEFINITIONS

Sec. 602. As used in this title—

(1) the term "depository institution" means—

(A) Any insured bank as defined in section 3 of the Federal Deposit Insurance Act or any bank which is eligible to make application to become an insured bank under section 5 of such Act;

(B) any mutual savings bank as defined in section 3 of the Federal Deposit Insurance Act or any bank which is eligible to make application to become an insured bank under section 5 of such Act;

(C) any savings bank as defined in section 3 of the Federal Deposit Insurance Act or any bank which is eligible to make application to become an insured bank under section 5 of such Act;

(D) any insured credit union as defined in section 101 of the Federal Credit Union Act or any credit union which is eligible to make application to become an insured credit union pursuant to section 201 of such Act;

(E) any member as defined in section 2 of the Federal Home Loan Bank Act; and

(F) any insured institution as defined in section 401 of the National Housing Act or any institution which is eligible to make application to become an insured institution under section 403 of such Act;

(2) the term "deposit account" means an account in a depository institution on which the account holder is permitted to make withdrawals by negotiable or transferable instrument, payment orders of withdrawal,

telephone transfers, or other similar items for the purpose of making payments or transfers to third persons or others. Such term includes demand deposits, negotiable order of withdrawal draft accounts, savings deposits subject to automatic transfers, share draft accounts, and all savings deposits and share accounts (other than time deposits); and

(3) the term "Board" means the Board of Governors of the Federal Reserve System.

DISCLOSURE OF FUND AVAILABILITY POLICIES

SEC. 603. (a) Before opening a transaction account, a depository institution shall, in accordance with regulations of the Board, provide a written disclosure to the potential customer of its general policy with respect to when a customer may withdraw funds deposited by check or similar instrument into the customer's deposit account.

(b) A depository institution shall, in accordance with regulations of the Board, either—

(1) furnish its customers preprinted deposit slips, or envelopes for automatic teller machine deposits, bearing a summary statement of its general policy with respect to when a customer may withdraw funds deposited by check or similar instrument into the customer's deposit account; or

(2) in the case of a particular deposit by check or similar instrument into a deposit account for which funds may not be immediately available for withdrawal, provide specific notice of the time the customer may withdraw such funds.

INTEREST ON DEPOSITS

SEC. 604. For the purpose of computing the amount of interest or dividends payable with respect to an interest bearing deposit account, a depository institution may not delay beginning to compute interest on funds deposited by check or similar instrument to such an account beyond the date on which that depository institution receives provisional credit for the check or similar instrument. Nothing in the preceding sentence requires the payment of interest with respect to funds deposited by check or similar instrument which is returned unpaid.

COMPLIANCE WITH ENDORSEMENT STANDARD

SEC. 605. Each depository institution shall place its endorsement on checks and other items described in regulations of the Board in the positions provided for in the endorsement standard (ANSI X 9.3–1981) or in regulations of the Board.

EXPEDITED NOTICE OF NONPAYMENT

SEC. 606. Not later than twenty-four hours after a payor depository institution determines not to pay a check or similar instrument of $250 or more, it shall directly notify the depository institution at which the check was originally deposited of such nonpayment.

DISCLOSURE GUIDELINES

SEC. 607. (a) The Board shall prescribe regulations to carry out this title. These regulations may contain such definitions, classifications, differentiations, or other provisions, and may provide for such adjustments and exemptions for any class of transactions, as the Board determines are necessary.

(b) The Board shall publish model disclosure forms and clauses for common transactions to facilitate compliance with the disclosure requirements of section 603 and to aid customers by utilizing readily understandable language. Nothing in this title may be construed to require the use of any such model form or clause prescribed by the Board under this section. A depository institution shall be deemed to be in compliance with the provisions of section 603 if it (1) uses any appropriate model form or clause as published by the Board, or (2) uses any such model form or clause and changes if by (A) deleting any information which is not required by this title, or (B) rearranging the format.

(c) Model disclosure forms and clauses shall be adopted by the Board after notice duly given in the Federal Register and an opportunity for public comment in accordance with section 553 of title 5, United States Code.

ADMINISTRATIVE ENFORCEMENT

SEC. 608. (a) Compliance with the requirements imposed under this title shall be enforced under—

(1) section 8 of the Federal Deposit Insurance Act in the case of—

(A) national banks, by the Comptroller of the Currency;

(B) member banks of the Federal Reserve System (other than national banks), by the Board; and

(C) banks insured by the Federal Deposit Insurance Corporation (other than members of the Federal Reserve System), by the Board of Directors of the Federal Deposit Insurance Corporation;

(2) section 5(d) of the Home Owner's Loan Act of 1933, section 407 of the National Housing Act, and section 17 of the Federal Home Loan Bank Act, by the Federal Home Loan Bank Board (acting directly or through the Federal Savings and Loan Insurance Corporation), in the case of any institution subject to any of those provisions; and

(3) the Federal Credit Union Act, by the Administrator of the National Credit Union Administration,

with respect to any Federal credit union or insured credit union.

(b) For the purpose of the exercise by any agency referred to in subsection (a) of this section of its powers under any Act referred to in that subsection, a violation of any requirement imposed under this title shall be deemed to be a violation of a requirement imposed under that Act. In addition to its powers under any provision of law specifically referred to in subsection (a) of this section, each of the agencies referred to in that subsection may excerise, for the purpose of enforcing compliance with any requirement imposed under this title, any other authority conferred on it by law.

(c) Except to the extent that enforcement of the requirements imposed under this title is specifically committed to some other Government agency under subsection (a) of this section, the appropriate State regulatory authority shall enforce such requirements.

(d) The authority of the Board to issue regulations under this title does not impair the authority of any other authority designated in this section to make rules respecting its own procedures in enforcing compliance with requirements imposed under this title.

CIVIL LIABILITY

SEC. 609. (a) Except as otherwise provided in this section, any depository institution which fails to comply with any requirement imposed under section 603 or 604 with respect to any person is liable to such person in an amount equal to the sum of—

(1) any actual damage sustained by such person as a result of the failure;

(2)(A) in the case of an individual action such additional amount as the court may allow, except that the liability under this subparagraph shall not be less than $50 nor greater than $500; or

(B) in the case of a class action, such amount as the court may allow, except that, as to each member of the class, no minimum recovery shall be applicable, and the total recovery under this subparagraph in any class action or series of class actions arising out of the same failure to comply by the same depository institution shall not be more than the lesser of $500,000 or 1 per centum of the net worth of the depository institution; and

(3) in the case of any successful action to enforce the foregoing liability, the costs of the action, together with a reasonable attorney's fee as determined by the court.

In determining the amount of award in any class action, the court shall consider, among other relevant factors, the amount of any actual damages awarded, the frequency and persistence of failures of compliance, the resources of the depository institution, the number of persons adversely affected, and the extent to which the failure of compliance was intentional.

(b) A depository institution may not be held liable in any action brought under this section for a violation of section 603 or 604 if the violation was not intentional and resulted from a bona fide error notwithstanding the maintenance of procedures reasonably adapted to avoid any such error. Examples of a bona fide error include, but are not limited to, clerical, calculation, computer malfunction and programing, and printing errors, except that an error of legal judgment with respect to a person's obligations under this title is not a bona fide error.

(c) Any action under this section may be brought in any United States district court, or in any other court of competent jurisdiction, within one year from the date of the occurrence of the violation.

(d) No provision of this section imposing any liability shall apply to any act done or omitted in good faith in conformity with any rule, regulation, or interpretation thereof by the Board or in conformity with any interpretation or approval by an official or employee of the Federal Reserve System duly authorized by the Board to issue such interpretations or approvals under such procedures as the Board may prescribe therefor, notwithstanding that after such act or omission has occurred, such rule, regulation, interpretation, or approval is amended, rescinded, or determined by judicial or other authority to be invalid for any reason.

EFFECTIVE DATE

SEC. 610. This title takes effect upon the expiration of twelve months following its enactment.

TITLE VII—CREDIT DEREGULATION AND AVAILABILITY

SHORT TITLE

SEC. 701. This title may be cited as the "Credit Deregulation and Availability Act of 1983".

BUSINESS AND AGRICULTURAL CREDIT

SEC. 702. (a) Section 511 of the Depository Institutions Deregulation and Monetary Control Act of 1980 (94 Stat. 161; Public Law 96–221) is amended to read as follows:

"BUSINESS AND AGRICULTURAL LOANS

"SEC. 511. (a) The provisions of the constitution or the laws of any State prohibiting, restricting, or in any way limiting the rate, nature, type, amount of, or the manner of calculating or providing or contracting for interest, discount, points, a time price differential, finance charges or other fees or charges that may be charged, taken, received, or reserved shall not apply in the case of business or agricultural credit.

"(b) As used in this part, the term—

"(1) 'agricultural credit' means credit extended primarily for agricultural purposes to a person that cultivates, plants, propagates, or nurtures an agricultural product;

"(2) 'agricultural purposes' include the production, harvest, exhibition, marketing, transportation, processing, or manufacturing of an agricultural product and the acquisition of farmland, real property with a farm residence and personal property and services used primarily in farming;

"(3) 'agricultural product' includes agricultural, horticultural, viticultural, and dairy products, livestock, wildlife, poultry, bees, forest products, fish and shellfish and any products thereof, including processed and manufactured products and any and all products raised or produced on farms and any processed or manufactured products thereof;

"(4) 'business credit' means credit extended primarily for business or commercial purposes, including investment, and any credit extended to a person other than a natural person; and

"(5) 'credit' includes all secured and unsecured loans, credit sales, forbearances, advances, renewals and other extensions of credit.".

(b) Section 512 of the Depository Institutions Deregulation and Monetary Control Act of 1980 is amended to read as follows:

"APPLICABILITY

"SEC. 512. (a) Except as provided in subsection (b) of this section, the provisions of this part shall apply with respect to business and agricultural credit extended on or after April 1, 1980.

"(b) The provisions of this part shall not apply to any business or agricultural credit extended in any State after the effective date (if such effective date occurs on or after April 1, 1980, and prior to three years after the effective date of the Credit Deregulation and Availability Act of 1983) of a State law or a certification that the voters of such States have voted in favor of any provision, constitutional or otherwise, which states explicitly and by its terms that such State does not want the provisions of this part to apply with respect to credit extensions subject to the laws of such State, except that such provisions shall apply to any credit extended on or after such date pursuant to a commitment to extend such credit which was entered into on or after April 1, 1980, and prior to such later date.

"(c) Credit shall be deemed to be extended during the period to which the provisions of this part apply if such credit extension—

"(1)(A)(i) is funded or made in whole or in part during such period, regardless of whether pursuant to a commitment or other agreement therefor made prior to April 1, 1980;

"(ii) was made prior to or on April 1, 1980, and bears or provides for interest during such period on the outstanding amount thereof at a variable or fluctuating rate; or

"(iii) is a renewal, extension, or other modification of an extension of credit made prior to April 1, 1980, and such renewal or extension or other modification is made during such period with the written consent of any person obligated to repay such credit; and

"(B)(i) has an original principal amount of $25,000 or more ($1,000 or more on or after the date of enactment of the Housing and Community Development Act of 1980 or any amount on or after the effective date of the Credit Deregulation and Availability Act of 1983); or

"(ii) is part of a series of advances if the aggregate of all sums advanced or agreed or contemplated to be advanced pursuant to a commitment or other agreement therefor is $25,000 or more ($1,000 or more on or after the date of enactment of the Housing and Community Development Act of 1980 or any amount on or after the effective date of the Credit Deregulation and Availability Act of 1983); or

"(2) is a renewal, extension, other modification or use of a credit agreement or extension made during such period, including an agreement entered during that period that contemplates future extensions of credit from time to time in which the charges that are assessed for or in connection with credit are calculated from time to time, in whole or in part, on the basis of the outstanding balance and the credit is extended not later than eighteen months after the effective date of the State law or certification.".

CONSUMER CREDIT

SEC. 703. Title V of the Depository Institutions Deregulation and Monetary Control Act of 1980 (94 Stat. 161; Public Law 96-221) is amended by adding at the end thereof the following new part:

"PART D—CONSUMER CREDIT

"CONSUMER CREDIT

"SEC. 531. The provisions of the constitution or laws of any State prohibiting, restricting, or in any way limiting the rate, nature, type, amount of, or the manner of calculating or providing or contracting for covered charges that may be charged, taken, received or reserved shall not apply to an extension of consumer credit made by a creditor.

"DEFINITIONS

"SEC. 532. (a) As used in this part—

"(1) the term 'covered charges' means—

"(A) interest, discount, points, a time price differential, or any similar fees, charges, or other compensation paid to the creditor and arising out of the credit agreement or transaction for the use of credit or credit services. The term shall not include, however, fees, charges or other amounts paid to the creditor or arising out of the credit agreement or transaction that are paid or arise solely as the result of the failure or refusal of the debtor to comply with the terms and conditions of the debtor's agreement with the creditor, including without limitation the fact that the obligation is not repaid in accordance with the payment schedule; and

"(B) fees or charges paid for the availability of credit, payment mechanism services, or for similar purposes, including periodic, transaction and access fees;

"(2) the term 'credit' includes all secured and unsecured loans, credit sales, forbearances, advances, renewals and other extensions of credit, all without regard to the nature of any property that might secure its repayment;

"(3) the term 'creditor' means any person that regularly makes extensions of consumer credit, which, for purposes of this definition, shall include extensions of credit that are subject to the provisions of section 501(a) of this title. A person is not a 'creditor' with respect to a specific extension of consumer credit if, except for this part, in order to assess or collect covered charges in connection with that transaction, the person would be required to comply with licensing requirements imposed under State law, unless such person is licensed under applicable State law and such person remains, or becomes, subject to the applicable regulatory requirements and enforcement mechanisms provided by State law; and

"(4) the term 'extension of consumer credit' means any credit extended to a natural person primarily for personal, family, or household purposes, except that it does not include credit subject to the provisions of section 501(a) or 511(a) of this title.

"APPLICABILITY

"SEC. 533. (a) Except as provided in subsection (b) of this section, the provisions of section 531 shall apply with respect to any extension of consumer credit made by a creditor on or after the effective date of the Credit Deregulation and Availability Act of 1983.

"(b)(1) The provisions of section 531 shall not apply to any extension of consumer credit in any State made on or after the effective date (if such effective date occurs on or after the effective date of the Credit Deregulation and Availability Act of 1983 and prior to a date three years after such effective date) of a State law or a certification that the voters of such State have voted in favor of any provision, constitutional or otherwise, which states explicitly and by its terms that such State does not want the provisions of this part to apply with respect to extensions of consumer credit subject to the laws of such State, except that such provisions shall apply to any consumer credit extended on or after such date pursuant to an agreement to extend such credit which was entered into on or after the effective date of the Credit Deregulation and Availability Act of 1983 and prior to such later date.

"(2) Credit shall be deemed to have been extended during the period to which the provisions of this part apply, if it—

"(A) is funded or extended in whole or in part during such period, regardless of whether pursuant to a commitment or other agreement therefor made prior to that period;

"(B) was made prior to such period and bears or provides for covered charges that may vary or fluctuate during that period;

"(C) is a renewal, extension, or other modification of a credit extension made before such period and such renewal, extension or other modification is made during such period with the written consent of any person obligated to repay such credit; or

"(D) is extended in accordance with an agreement entered into prior to the effective date of the State law or certification that contemplates future extensions of consumer credit from time to time in which the covered charges are calculated from time to time, in whole or in part, on the basis of the outstanding balance and the credit is extended not later than eighteen months after the effective date of the State law or certification.

"(c) Any law or certification adopted by a State or its voters pursuant to subsection (b) of this section may specify that portion of the extension of consumer credit made in such State, or those types or kinds of covered charges, to which the provisions of section 531 will not apply.

"INTERPRETIVE AUTHORITY

"SEC. 534. (a) The Board of Governors of the Federal Reserve System is authorized to publish Board interpretations regarding the scope and application of section 531 of this part. Upon its own motion or upon the request of any creditor, State, or other interested party which is submitted to the Board in accordance with procedures it establishes, within one hundred and twenty days the Board shall issue an official interpretation regarding the scope of section 531 and its relationship to specific provisions of State law, or shall make public a Board determination (accompanied by an appropriate explanation) that the question presented does not involve a significant issue or does not affect a substantial number of creditors or extensions of consumer credit.

"(b) No provision of the constitution or laws of any State imposing any liability, penalty, or forfeiture shall apply to any act done or omitted in good faith in conformity with any interpretation under this section by the Board, notwithstanding that, after such act of omission has occurred, such interpretation is amended, rescinded, or determined by judicial or other authority to be invalid for any reason.".

FEDERAL CREDIT UNIONS

SEC. 704. Section 107(5)(A)(vi) of the Federal Credit Union Act (12 U.S.C. 1757(5)(A)(vi)) is amended to read as follows:

> "(vi) rates of interest shall be established by the board of directors of the Federal credit union;".

EFFECTIVE DATE

SEC. 705. This title shall take effect upon its enactment.

TITLE VIII—INTEREST ON DEMAND DEPOSITS

SHORT TITLE

SEC. 801. This title may be cited as the "Demand Deposit Deregulation Act".

AMENDMENTS TO THE FEDERAL RESERVE ACT

SEC. 802. (a) The first and second sentences of section 19(i) of the Federal Reserve Act (12 U.S.C. 371a) are hereby repealed.

"(b) The third sentence of section 19(i) of the Federal Reserve Act is amended by striking out "Notwithstanding any other provision of this section, a" and inserting in lieu thereof "A".

AMENDMENT TO THE FEDERAL DEPOSIT INSURANCE ACT

SEC. 803. The first sentence of section 18(g)(1) of the Federal Deposit Insurance Act (12 U.S.C. 1828(g)(1)) is hereby repealed.

AMENDMENT TO THE HOME OWNERS' LOAN ACT OF 1933

SEC. 804. The second sentence of section 5(b)(1)(B) of the Home Owners' Loan Act of 1933 (12 U.S.C. 1464(b)(1)(B)) is hereby repealed.

AMENDMENT TO SECTION 19(b) OF THE FEDERAL RESERVE ACT

SEC. 805. Section 19(b) of the Federal Reserve Act (12 U.S.C. 461(b)) is amended by striking the last sentence in subparagraph (8)(A) and inserting in lieu thereof the following: "This subparagraph does not apply to (1) any category of deposits or accounts which are first authorized pursuant to Federal law in any State after April 1, 1980; nor (2) an amount equal to the amount by which current total demand deposits exceeds the amount of demand deposits held by the institution on a daily average basis during the fourteen-day period preceding the date of enactment of this Act, held by each depository institution located outside of Connecticut, Maine, Massachusetts, New Hampshire, New Jersey, New York, Rhode Island, and Vermont, except as permitted by order or regulation of the Board.".

AMENDMENT TO THE DEPOSITORY INSTITUTIONS DEREGULATION ACT OF 1980

SEC. 806. Section 204 of the Depository Institutions Deregulation Act of 1980 (12 U.S.C. 3503) is amended by adding at the end thereof a new subsection (d) to read as follows:

"(d) The Deregulation Committee shall not later than six months from the effective date of this Act establish rules permitting the payment of interest on demand deposits at the same rates that are permitted for accounts subject to withdrawal by negotiable or transferable instrument for the purpose of making transfers to third parties authorized under section 2(a) of Public Law 93–100 (12 U.S.C. 1832(a)). Interest may not be paid by a depository institution on any demand deposit until such rules are issued by the Deregulation Committee.".

TECHNICAL AMENDMENTS

SEC. 807. (a) Section 207(b)(2) of the Depository Institutions Deregulation Act of 1980 (12 U.S.C. 3506(b)(2)) is amended to read as follows:

"(2) the first sentence of section 18(g) of the Federal Deposit Insurance Act (12 U.S.C. 1828(g)) is amended by striking out 'payment and' and by striking out ', including limitations on the rates of interest and dividends that may be paid;' ".

(b) Section 207(b)(3) of such Act (12 U.S.C. 3506(b)(3)) is amended to read as follows:

"(3) the second, fourth, and seventh sentences of section 18(g) of the Federal Deposit Insurance Act (12 U.S.C. 1828(g)) are hereby repealed;".

(c) The second sentence of section 203(b) of such Act (12 U.S.C. 3502(b)) is hereby repealed.

NOW ACCOUNTS

SEC. 808. Section 2(a)(2) of Public Law 93-100 (12 U.S.C. 1832(a)) is amended by inserting "political" after the comma following "educational".

EFFECTIVE DATE

SEC. 809. This title shall take effect one hundred and eighty days from the date of enactment, except that section 808 shall take effect on the date of enactment of this Act.

TITLE IX—FRAUDULENT USE OF CREDIT CARDS AND DEBIT CARDS

FRAUDULENT USE OF CREDIT CARDS

SEC. 901. Section 134 of the Truth in Lending Act (15 U.S.C. 1644) is amended to read as follows:

"§ 134. Fraudulent use of credit card

"(a) Whoever—

"(1) knowingly, in a transaction affecting interstate or foreign commerce, uses or attempts or conspires to use any counterfeit, fictitious, altered, forged, lost, stolen, or fraudulently obtained credit card to obtain money, goods, services, or anything else of value which within any one-year period has a value aggregating $1,000 or more;

"(2) with unlawful or fraudulent intent, transports or attempts or conspires to transport in interstate or foreign commerce a counterfeit, fictitious, altered, forged, lost, stolen, or fraudulently obtained;

"(3) with unlawful or fraudulent intent, uses any instrumentality of interstate or foreign commerce to sell or transport a counterfeit, fictitious, altered, forged, lost, stolen, or fraudulently obtained credit card knowing the same to be counterfeit, fictitious, altered, forged, lost, stolen, or fraudulently obtained;

"(4) knowingly receives, conceals, uses, or transports money, goods, services, or anything else of value (except tickets for interstate or foreign transportation) which (A) within any one-year period has a value aggregating $1,000 or more, (B) has moved in or is part of, or which constitutes interstate or foriegn commerce, and (C) has been obtained with a counterfeit, fictitious, altered, forged, lost, stolen, or fraudulently obtained credit card;

"(5) knowingly receives, conceals, uses, sells, or transports in interstate or foreign commerce one or more tickets for interstate or foreign transportation, which (A) within any one-year period have a value aggregating $500 or more, and (B) have been purchased or obtained with one or more counterfeit, fictitious, altered, forged, lost, stolen, or fraudulently obtained credit cards;

"(6) in a transaction affecting interstate or foreign commerce, furnishes money, property, services, or anything else of value, which within any one-year period has a value aggregating $1,000 or more, through the use of any counterfeit, fictitious, altered, forged, lost, stolen, or fraudulently obtained credit card knowing the same to be counterfeit, fictitious, altered, forged, lost, stolen, or fraudulently obtained;

"(7) in a transaction affecting interstate or foreign commerce, knowingly furnishes, transfers, or obtains a credit card for use in connection with a scheme to defraud a consumer or any other person;

"(8) in a transaction affecting interstate or foreign commerce, with unlawful or fraudulent intent, furnishes, acquires or uses any actual or fictitious credit card account numbers or identification or other access codes, whether alone or together with names of credit card holders, or other information pertaining to a credit card account in any form, and as they may be reflected or retained in any medium; or

"(9) with unlawful or fraudulent intent, possesses five or more counterfeit, fictitious, altered, forged, lost, stolen, or fraudulently obtained credit cards that have moved in, been a part of, or constituted interstate or foreign commerce, shall be fined not more than $10,000 or imprisoned not more than ten years, or both.

"(b)(1) In determining the aggregate value for the purpose of any provision of subsection (a), there shall be included the dollar value of all transactions by a person using one or more credit cards in a course of conduct in violation of such provision.

"(2) As used in this section, the term 'credit card' includes account numbers or any other means of account access that can be used, alone or in conjunction with another means of access to obtain money, goods, services, or any other thing of value.

"(c) Any person who is convicted of a violation of any provision of subsection (a) or section 916 shall, for any subsequent violation of a provision of subsection (a) or section 916, be fined not more than $100,000 or imprisoned not more than 20 years, or both.".

FRAUDULENT USE OF DEBIT CARDS

SEC. 902. (a) Section 916(b) of the Electronic Fund Transfer Act (15 U.S.C. 1693n(b)) is amended by striking out "obtained—" in paragraph (6) and inserting in lieu thereof the following: "obtained; or

"(7) in a transaction affecting interstate or foreign commerce, knowingly furnishes, transfers, or obtains a debit instrument for use in connection with a scheme to defraud a consumer or any other person; or

"(8) in a transaction affecting interstate or foreign commerce, with unlawful or fraudulent intent, furnishes, acquires, or uses any actual or fictitious account numbers or identification or other access codes, whether alone or together with names of account holders, or other information pertaining to a debit instrument in any form, and as they may be reflected or retained in any medium; or

"(9) with unlawful or fraudulent intent, possesses five or more counterfeit, fictitious, altered, forged, lost, stolen, or fraudulently obtained debit instruments that have moved in, been a part of, or constituted interstate or foreign commerce—".

(b) Section 916(c) of such Act is amended by inserting after "card, code," the following: "account number, other means of account access (that can be used, alone or in conjunction with another access device, to obtain money, goods, services, or any other things of value or for the purpose of initiating a transfer of funds (except a transfer originated solely by a paper instrument)),".

(c) Section 916 of such Act is amended by adding at the end thereof the following:

"(d) In determining the aggregate value for the purpose of any provision of subsection (b), there shall be included the dollar value of all transactions by a person using one or more debit instruments in a course of conduct in violation of such provision.

"(e) Any person who is convicted of a violation of any provision of subsection (b) or of section 134 shall for any subsequent violation of a provision of subsection (b) or section 134, be fined not more than $100,000 or imprisoned not more than 20 years, or both.".

TITLE X—INTERSTATE BANKING

SHORT TITLE

SEC. 1001. This title may be cited as the "Interstate Banking Act of 1983".

AMENDMENT TO SECTION 5155 OF THE REVISED STATUTES

SEC. 1002. The first sentence of subsection (c) of section 5155 of the Revised Statutes (12 U.S.C. 36) is amended—

(1) by striking out "and" before "(2)"; and

(2) by inserting before the period the following: "; and (3) within any other State in which such establishment and operation are at the time authorized to State banks by statute law by language specifically granting such authority affirmatively and not merely by implica-

tion or recognition, subject to any restriction as to location imposed by the laws of the other State on State banks and subject to other limitations in the law of the other State such as the geographic location or proximity of the State in which the association is situated, and subject to such State having in effect a law providing reciprocal treatment of its State banks".

AMENDMENT TO THE BANK HOLDING COMPANY ACT OF 1956

SEC. 1003. Section 3(d) of the Bank Holding Company Act of 1956 (12 U.S.C. 1842(d)) is amended by adding at the end thereof the following: "State laws which authorize a bank holding company the banking operations of which are principally conducted in another State to acquire, directly or indirectly, any voting shares of, interest in, or all or substantially all of the assets of any additional bank located in a State may grant such authority on the basis of limitations such as the geographic location or proximity of such other State or on the basis of such other State having in effect a law providing reciprocal treatment for such transactions.".

AMENDMENTS TO THE HOME OWNERS' LOAN ACT OF 1933

SEC. 1004. (a) Section 5(a) of the Home Owner's Loan Act of 1933 (12 U.S.C 1464(r)) is amended by adding at the end thereof the following:

"(4) An association may establish and operate a branch in any State where the establishment and operation of a branch by an out-of-State association are authorized by statute in language specifically granting such authority affirmatively and not merely by implication or recognition, and subject to any restriction as to location imposed by the laws of the State on State associations. Such statute may grant such authority subject to limitations such as the geographic location or proximity of the other State or subject to such other State having in effect a law providing reciprocal treatment for such establishment and operation.".

(b) Section 5(d)(11) of such Act (12 U.S.C. 1464(d)(11)) is amended—

(1) by inserting "(A)" after "(11)"; and

(2) by adding at the end thereof the following:

"(B) In considering any reorganization or merger involving an association, the Board shall give effect to any State law under which a reorganization or merger involving an association from that State and an association or other financial institution from another State is authorized by statute in language specifically granting such authority affirmatively and not merely by implication or recognition and subject to any restriction as to location imposed by the laws of that State. Such statute may grant such authority subject to limitations such as the geographic location or proximity of the other State or subject to such other State having in effect a law providing reciprocal treatment for such reorganizations or mergers.".

AMENDMENT TO THE NATIONAL HOUSING ACT

SEC. 1005. Section 408(e)(3)(B) of the National Housing Act (12 U.S.C. 1730a(e)(3)(B)) is amended by inserting before the period at the end thereof the following: ", except that the Corporation shall give effect to any State laws which permit a savings and loan holding company whose operations are principally conducted in any other State to acquire, directly or indirectly, any voting shares of, interest in, or all or substantially all of the assets of any additional association located in that State which laws may permit such acquisition subject to limitations such as the geographic location or proximity of the other State or subject to the other State having in effect a law providing reciprocal treatment for such acquisitions".

AMENDMENTS TO THE FEDERAL DEPOSIT INSURANCE ACT

SEC. 1006. (a) Section 18(d) of the Federal Deposit Insurance Act (12 U.S.C. 1828(d)) is amended by adding at the end thereof the following:

"(3) In considering the application of any State nonmember bank, the Corporation shall give effect to any State laws under which the establishment and operation of a branch by an out-of-State nonmember bank are authorized by statute in language specifically granting such authority affirmatively and not merely by implication or recognition and subject to the restrictions as to location imposed by the laws of the State on State nonmember insured banks. Such State laws may grant such authority subject to limitations such as the geographic location or proximity of the other State or subject to such other State having in effect a law providing reciprocal treatment for such establishment and operation.".

(b) Section 18(c)(5) of such Act (12 U.S.C. 1828(c)(5)) is amended—

(1) by redesignating subparagraphs (A) and (B) as clauses (i) and (ii), respectively;

(2) by inserting "(A)" after "(5)"; and

(3) by adding at the end thereof the following:

"(B) In reviewing any merger transaction, the responsible agency shall give effect to the laws of a State under which a merger transaction involving a bank from that State and a bank from another State is authorized by statute in language specifically granting such authority affirmatively and not merely by implication or recognition and subject to any restriction as to location imposed by the laws of that State. Such State laws grant such authority subject to limitations such as the geographic location or proximity of the other State or subject to such other State having in effect a law providing reciprocal treatment for such mergers.".

SUNSET

SEC. 1007. (a) Effective upon the expiration of five years after the date of enactment of this title—

(1) section 5155(c)(3) of the Revised Statutes, as added by section 1002 of this title, is repealed;

(2) section 7(b) of the Bank Holding Company Act of 1956, as added by section 1003 of this title, is repealed;

(3) section 5(r)(4) of the Home Owners' Loan Act of 1933, as added by section 1004 of this title, is repealed;

(4) that part of section 408(e)(3) of the National Housing Act which was added by section 1005 of this title is repealed;

(5) section 18(d)(3) of the Federal Deposit Insurance Act, as added by section 1006 of this title, is repealed;

(6) section 18(c)(5)(B) of the Federal Deposit Insurance Act, as added by section 1007 of this title, is repealed; and

(7) section 5(d)(11) (B) of the Home Owners' Loan Act of 1933, as added by section 1008 of this title, is repealed.

(b) The repeal or termination by subsection (a) of any amendments made by this title shall have no effect on any action taken or authorized while such amendment was in effect. Any bank or other institution the shares or assets of which are acquired in reliance upon the amendments made by this title shall after repeal of the amendments made by this title have the same powers with respect to the establishment of branch offices and merger or consolidation with other institutions, as it would have had if its shares or assets not been so acquired.

REPORT

SEC. 1008. (a) The President, in consultation with the Attorney General, the Secretary of the Treasury, the Board of Governors of the Federal Reserve System, the Comptroller of the Currency, and the Federal Deposit Insurance Corporation, shall transmit a report to the Congress concerning the effect, if any, that this title has had on the financial, economic, and banking environment and on particular banks, bank holding companies, savings and loan associations, and saving banks. There shall be included in this report legislative recommendations as to whether the sunset provisions of section 1009 should be allowed to take effect.

(b) The report required by subsection (a) shall be transmitted to the Congress not later than four years after the date of enactment of this title.

○

II

98TH CONGRESS
1ST SESSION

S. 2134

To establish the permissible scope of powers for depository institutions and their holding companies consistent with their safe and sound operations, to simplify the procedures for engaging in such activities, and for other purposes.

IN THE SENATE OF THE UNITED STATES

NOVEMBER 18 (legislative day, NOVEMBER 14), 1983

Mr. PROXMIRE introduced the following bill; which was read twice and referred to the Committee on Banking, Housing, and Urban Affairs

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A BILL

To establish the permissible scope of powers for depository institutions and their holding companies consistent with their safe and sound operations, to simplify the procedures for engaging in such activities, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SHORT TITLE

SECTION 1. This Act may be cited as the "Depository Institutions Holding Company Act Amendments of 1983".

AMENDMENTS TO THE BANK HOLDING COMPANY ACT

SEC. 2. Section 2 of the Bank Holding Company Act of 1956, as amended (12 U.S.C. 1841), is hereby amended:

(1) by amending subsection (c) to read as follows:

"(c) 'Bank' means (1) an 'insured bank' as that term is defined in section 3(h) of the Federal Deposit Insurance Act (12 U.S.C. 1813(h)); (2) any institution that is eligible to become an insured bank pursuant to section 5 of the Federal Deposit Insurance Act (12 U.S.C. 1815); or (3) any institution organized under the laws of the United States, any State of the United States, the District of Columbia, any territory of the United States, Puerto Rico, Guam, American Samoa, or the Virgin Islands, that accepts deposits that the depositor may withdraw by check or similar means for payment to third parties and is engaged in the business of making commercial loans. The term 'bank' does not include (A) any foreign bank having an insured branch in the United States; (B) an insured institution; (C) any organization operating under section 25 or section 25(a) of the Federal Reserve Act; (D) any organization that does not do business in the United States except as an incident to its activities outside the United States; or (E) any institution that functions solely as a trust company, such as the type described in section 92a(a) of title 12, United States Code, and all or substantially all of the deposits of which are received solely in a fiduciary capacity."; and

(2) by inserting after subsection (i) the following new subsections:

"(j) The term 'securities affiliate' means any corporation that (1) is engaged in the United States in one or more of the activities authorized pursuant to section 4(c)(15) of this Act, and (2) is a broker or dealer within the meaning of the Securities Exchange Act of 1934, as amended (15 U.S.C. 78c(a) (4) and (5)), or an investment adviser within the meaning of the Investment Advisers Act of 1940, as amended (15 U.S.C. 80b–2(11)). For purposes of this chapter, a corporation engaged in any such activities shall be deemed to be a securities affiliate only so long as it is a bank holding company or is owned or controlled by a bank holding company.

"(k) the term 'insured institution' has the meaning ascribed to it in section 408 of the National Housing Act (12 U.S.C. 1730a(a)(1)).".

Sec. 3. Section 3 of the Bank Holding Company Act of 1956, as amended (12 U.S.C. 1842), is hereby amended by deleting the word "or" before the letter "(B)" in the second sentence of subsection (a) thereof and by adding the following new subparagraph immediately preceding the period at the end of the second sentence of subsection (a): "; or (C) with thirty days prior notification to the Board, the acquisition by a company of control of a bank in a reorganization in which a person or group of persons exchange their shares of the bank for shares of a newly formed bank holding company and receive after such reorganization, substantially the same proportional share interest in the holding company as they held in the bank except for changes in shareholder interests resulting from the exercise of dissenting shareholder rights under State or Federal law: *Provided,* That, immediately following such acquisition, the bank holding company meets the capital and other financial standards prescribed by the Board by regulation for such a bank holding company and the holding company does not engage in any activities other than those of banking or managing and controlling banks. In promulgating regulations pursuant to this subsection, the Board shall not require more capital for the subsidiary bank immediately following the reorganization that is required for a similarly sized bank that is not a subsidiary of a bank holding company".

SEC. 4. Subsection 4(a)(2) of the Bank Holding Company Act of 1956, as amended (12 U.S.C. 1843(a)(2)), is hereby amended:

(1) by amending subparagraph (B) of such subsection to read as follows: "(B) those permitted under paragraphs (8) and (15) of subsection (c) of this section subject to all the conditions and requirements specified in each respective paragraph or in any order or regulation issued by the Board under such paragraphs"; and

(2) by adding the following additional proviso at the end of such subsection: ":*Provided further,* (I) That the two-year period referred to in this paragraph shall

not apply to a company that becomes a bank holding company as a result of enactment of the Depository Institutions Holding Company Act of 1983, and that acquired a bank between June 23, 1983, and the effective date of such Act; and (II) That a company that becomes a bank holding company as a result of the enactment of the Depository Institutions Holding Company Act of 1983, and that controlled an insured bank on June 23, 1983, may engage in any activity in which it was lawfully engaged, directly or indirectly, on June 23, 1983, and in which it has been engaged continuously since June 23, 1983: *Provided*, That any activities authorized for such a bank holding company may not be expanded and any additional activities may not be commenced except in accordance with the requirements, conditions, and limitations applicable to bank holding companies under this Act. The authority conferred by the preceding clause (II): (a) shall terminate at such time as (1) any bank holding company covered by clause (II) acquires control of an additional bank or an insured institution, (2) any of such bank holding company's existing subsidiary banks commences accepting deposits that the depositor has a legal right to withdraw on demand and engages in the business of making commercial loans, or (3) such bank holding company covered by clause (II) commences, directly or indirectly, after June 23, 1983, any additional activities, other than those activities authorized pursuant to this Act, in which it was not engaged on June 23, 1983; and (b) may be terminated by the Board by order, after opportunity for hearing, if it determines, having due regard to the purposes of this chapter, that such action is necessary to prevent conflicts of interests or unsound banking practices or is in the public interest.".

SEC. 5. Subsection 4(c) of the Bank Holding Company Act of 1956, as amended (12 U.S.C 1843(c)), is hereby amended:

(1) by deleting paragraph (8) and replacing it with the following new paragraph:

"(8)(A) shares of any company the activities of which the Board has determined by regulation, or by order after notice, to be closely related to banking or managing or controlling banks.

"(B)(i) No bank holding company shall engage directly or indirectly in any activity authorized under this paragraph either de novo or by an acquisition in whole or in part of a going concern, unless the Board has been given sixty days prior written notice of such proposal and, within such period, the Board has not issued an order disapproving the proposal or suspending the time period in accordance with clause (iii) of this subparagraph.

"(ii) An acquisition may be made prior to the expiration of the disapproval period specified in clause (i) of this subparagraph, if the Board issues a written notice of its intent not to disapprove the transaction. The Board may provide for no notice under this paragraph or notice for a shorter period of time with respect to particular activities. No notice under this paragraph is required in the event a bank holding company establishes de novo an office to engage in any activity previously authorized for such a bank holding company under this paragraph, or changes the location of an office engaged in such activity, unless the company has been notified that a notice is required based upon any of the criteria specified in clause (iv) of this subparagraph.

"(iii) Any notice required under this paragraph shall contain such information as the Board may prescribe by regulation or by specific request in connection with a particular notice. The Board may require only such information as may be relevant to the nature, scope, or permissibility of the proposed activity and to the Board's evaluation of the criteria in clause (iv) of this subparagraph. In the event the Board requires additional relevant information beyond that provided in the notice submitted pursuant to this paragraph, the Board may by order suspend the time period provided in clause (i) of this subparagraph until it has received such additional relevant information. The activity that is the subject of the notice may be commenced at the expiration of thirty days from the date of receipt by the Board of such additional relevant information, unless the Board issues a disapproval order as provided in clause (i) of this subparagraph or at such earlier date as may be authorized under clause (ii) of this subparagraph. A suspension order issued under this clause is reviewable under section 9 of this Act.

"(iv) In evaluating a notice under this paragraph, the Board may consider the following criteria:

"(I) the managerial resources of the companies involved;

"(II) the adequacy of their financial resources, including their capital, giving consideration to the financial resources and capital of others engaged in similar activities: *Provided,* That the Board shall not require a higher level of capital for any activity subject to Federal or State regulation than would be required by the applicable regulatory authority for a company engaged in such activity, unless the Board shall find that particular circumstances warrant a higher level of capital;

"(III) any practice or arrangement that may adversely affect the independence or impartiality of an affiliated bank in the provision of credit or other services or the terms on which such credit and services are made available, or the availability of such credit; and

"(IV) any material adverse effect on the safety and soundness or financial condition of an affiliated bank or banks.

"(v) The Board shall by order set forth the reasons for any disapproval under this paragraph. Inaction on any notice, or a Board order determining not to disapprove a proposal to engage in an activity that has previously been authorized by regulation under this paragraph, shall be final and shall not be subject to judicial review under this Act or in any other manner. Any company may obtain judicial review pursuant to section 9 of this Act of any Board order not to disapprove a notice filed by such company under this paragraph if such order contains restrictions or conditions.

"(vi) A bank holding company may petition the Board to determine by regulation that a particular activity is closely related to banking. The Board may by regulation prescribe limitations on the conduct of any activity authorized under paragraph (8) or (15) of this subsection consistent with the criteria in clause (iv) of this subparagraph and with safe and sound financial practices. In administering this paragraph, the Board shall promote competition between bank holding companies and other companies engaged in activities closely related to banking.

"(vii) The Board shall not after the date of enactment of this paragraph designate as an activity closely related to banking within the meaning of this paragraph any activity that is described in clauses (i) and (ii) of subparagraph (B) of paragraph (15) of this subsection or that is prohibited to a member bank or to an affiliate of a member bank under sections 16 (12 U.S.C. 24 (Seventh)) or 20 (12 U.S.C. 377) of the Banking Act of 1933, as amended.

"(viii) Notwithstanding any other provision of this Act, if the Board finds that an emergency exists which requires the Board to act immediately on any notice or application under this subsection involving a thrift institution, and the primary Federal regulator of such institution concurs in such finding, the Board may dispense with any notice or other requirement of this subsection.

"(C) For purposes of this paragraph, it is not closely related to banking or managing or controlling banks for a bank holding company to provide insurance as a principal, agent, or broker except (i) where the insurance is limited to assuring repayment of the outstanding balance due on a specific extension of credit by a bank holding company or its subsidiary in the event of the death, disability, or involuntary unemployment of the debtor; (ii) in the case of a finance company which is a subsidiary of a bank holding company, where the insurance is also limited to assuring repayment of the outstanding balance on an extension of credit in the event of loss or damage to any property used as collateral on such extension of credit and such extension of credit is not more than an amount equal to $10,000 ($25,000 in the case of an extension of credit which is made to finance the purchase of a residential manufactured home and which is secured by such residential manufactured home) increased by the percentage increase in the Consumer Price Index for Urban Wage Earners and Clerical Workers published monthly by the Bureau of Labor Statistics for the period beginning on January 1, 1982, and ending on December 31 of the year preceding the year in which such extension of credit is made; (iii) any insurance agency activity in a place that (I) has a population not exceeding five thousand (as shown by the last preceding decennial census), or (II) the bank holding company, after notice and opportunity for a hearing, demonstrates it has inadequate insurance agency facilities; (iv) any insurance agency activity which was engaged in by the bank holding company or any of its subsidiaries on May 1, 1982, or which the Board approved for such company or any of its subsidiaries on or before May 1, 1982, including (I) sales of insurance at new locations of the same bank holding company or the same subsidiary or subsidiaries with respect to which insurance was sold on May 1, 1982, or approved to be sold on or before May 1, 1982, if such new locations are confined to the State in which the principal place of business of the bank holding company is located, any State or States immediately adjacent to such State, and any State or States in which insurance activities were conducted by the bank holding company or any of its subsidiaries on May 1, 1982, or were approved to be conducted by the bank holding company or any of its subsidiaries on or before May 1, 1982, and (II) sales of insurance coverages which may become available after May 1, 1982, so long as those coverages insure against the same types of risks as, or are otherwise functionally equivalent to, coverages sold on May 1, 1982, or approved to be sold on or before May 1, 1982 (for purposes of this subparagraph, activities engaged in or approved by the Board on May 1, 1982, shall include activities carried on subsequent to that date as the result of an application to engage in such activities pending on May 1, 1982, and approved subsequent to that date or of the acquisition by such company pursuant to a binding written contract entered into on or before May 1, 1982, of another company engaged in such activities at the time of the acquisition); (v) any insurance activity where the activity is limited solely to supervising on behalf of insurance underwriters the activities of retail insurance agents who sell (I) fidelity insurance and property and casualty insurance on the real and personal property used in the operations of the bank holding company or any of its subsidiaries, and (II) group insurance that protects the employees of the bank holding company or any of its subsidiaries; (vi) any insurance agency activity engaged in by a bank holding company, or any of its subsidiaries, which bank holding company has total assets of

$50,000,000 or less: *Provided, however,* That such a bank holding company and its subsidiaries may not engage in the sale of life insurance or annuities except as provided in clauses (i), (ii), or (iii) of this subparagraph; or (vii) where the activity is performed, or shares of the company involved are owned, directly or indirectly, by a bank holding company which is registered with the Board of Governors of the Federal Reserve System and which, prior to January 1, 1971, was engaged, directly or indirectly, in insurance agency activities as a consequence of approval by the Board prior to January 1, 1971.".

(2) by adding following paragraph (14) the following new paragraph (15):

"(15) (A) shares of any securities affiliate the activities of which consist of:

"(i) dealing in or underwriting obligations issued or guaranteed by or on behalf of a State or any political subdivision thereof or any agency or instrumentality of either of the foregoing, except industrial development bonds as defined in section 103(b)(2) of the Internal Revenue Code of 1954, as amended: *Provided, however,* That a securities affiliate may deal in and underwrite such industrial development bonds, the interest on which is exempt from Federal income tax under section 103(a) of the Internal Revenue Code of 1954, as amended, if: (I) a State, territory, possession of the United States, or any political subdivision of the foregoing, or the District of Columbia pledges its full faith and credit for the payment of all principal and interest on such bonds or (II) the issuer, or the State or local governmental unit on behalf of which the industrial development bonds were issued, is considered the sole owner, for Federal income tax purposes, of the facility with respect to which financing is to be provided from the proceeds of such industrial development bonds;

"(ii) dealing in or underwriting securities backed by pools of residential mortgage loans;

"(iii) organizing, sponsoring, operating, controlling, providing investment advice to, or underwriting, distributing, or selling the shares of an investment company, as such term is defined in section 3 of the Investment Company Act of 1940, as amended (15 U.S.C. 80a-3); or

"(iv) any securities or securities-related activity that a national or state member bank is not prohibited by law from conducting directly.

"(B) No bank holding company that engages in any activity described in clauses (i), (ii), or (iii) of subparagraph (A) of this paragraph through a securities affiliate shall, after one year from the date on which any such securities affiliate first engages in any of such activities, permit a bank or insured institution controlled by such holding company to engage, directly or indirectly, in the United States in such activities (other than organizing, sponsoring, operating, controlling or providing investment advice to a closed-end investment company) or in any of the following activities: (i) dealing in or underwriting any obligation of the United States and any other obligation listed in paragraph Seventh of section 5136 of the Revised Statutes of the United States, as amended (12 U.S.C. 24), and (ii) purchasing and selling securities and stock as agent. For purposes of this subparagraph, the Board may, by regulation or order, determine additional securities or securities-related activities in which such bank or insured institution may not engage. No rule, regulation or order of the Board, however, shall prohibit a bank or insured institution from engaging in those securities or securities-related activities that are necessary or incidental to the financing of such bank or insured institution or to the investment of its funds. In the event that a securities affiliate controlled by a bank holding company terminates all of the activities specified in clauses (i), (ii), and (iii) of subparagraph (A) of this paragraph, any bank or insured institution that is controlled by such bank holding company may conduct any securities or securities-related activities that it is authorized by law to conduct.

"(C) A bank holding company seeking to acquire shares of a securities affiliate or engage directly in securities or securities-related activities pursuant to this paragraph shall comply with the prior notification and other requirements and limitations of paragraph (8) of this subsection."; and

(3) by deleting the penultimate sentence thereof, which begins "In the event".

SEC. 6. Subsection 5(c) of the Bank Holding Company Act, as amended (12 U.S.C. 1844(c)), is hereby amended to read as follows:

"(c)(1) The Board from time to time may require reports under oath, in such scope and detail as it may determine, of a bank holding company and each subsidiary thereof to keep the Board informed as to whether such companies are complying with the provisions of this Act and regulations and orders issued thereunder.

"(2) Except where the Board determines that a lesser reporting requirement is appropriate, the Board shall accept in fulfillment of the reporting requirements established pursuant to this subsection for nonbank subsidiaries separate reports consisting of: (A) for companies subject to the reporting requirements of section 17 of the Securities Exchange Act of 1934 (15 U.S.C. 78q), the same information required to be submitted to the Securities and Exchange Commission under such section (and the rules and regulations thereunder) at the same time such information is so submitted; and (B) for all other companies the same information as would be required to be submitted under section 13 of the Securities Exchange Act of 1934 (15 U.S.C. 78m) (and the rules and regulations thereunder) by companies subject to the reporting requirements of such Act, that are engaged in the same or similar lines of business, not more frequently than quarterly. In particular circumstances, the Board may require additional information in order to fulfill its responsibilities under this Act.

"(3) The Board may make examinations of each bank holding company and each subsidiary thereof, the cost of which may be assessed against, and paid by, such holding company. The Board shall, however, insofar as possible, minimize the scope and frequency of examinations of nonbank subsidiaries of a bank holding company by utilizing, where feasible, reports of applicable regulatory agencies or other bodies public or private, and by directing, to the extent feasible, the focus of such examinations to the activities or financial condition of such nonbank subsidiaries that may have a materially adverse effect on the safety and soundness or financial condition of a subsidiary bank of the bank holding company.".

SEC. 7. Section 7 of the Bank Holding Company Act of 1956, as amended (12 U.S.C. 1846), is hereby amended by striking out the period at the end thereof and inserting the following: ": *Provided, however,* That no State shall prohibit the affiliation of a national banking association, as such term is used in section 21 of this title, with a company engaged only in one or more of the activities described in paragraphs (8) and (15) of subsection 4(c) of this Act.".

SEC. 8. Section 11 of the Bank Holding Company Act of 1956, as amended (12 U.S.C. 1849), is hereby amended by inserting after the fourth sentence of subsection (b) thereof the following new sentence: "The Board may shorten or eliminate this thirty day period with the consent of the Attorney General.".

AMENDMENTS TO THE BANK MERGER ACT OF 1966

SEC. 9. Section 18(c) of the Bank Merger Act of 1966 12 U.S.C. 1828(c), is hereby amended by inserting at the end of paragraph (6) thereof the following new sentence: "The responsible agency may shorten or eliminate this thirty-day period with the consent of the Attorney General.".

AMENDMENTS TO THE BANKING ACT OF 1933

SEC. 10. Section 20 of the Banking Act of 1933, as amended (12 U.S.C. 377), is hereby amended by adding the following new paragraph at the end of the first paragraph of such section:

"Notwithstanding any other provision of this section, a member bank may be affiliated in any manner described in subsection (b) of section 221a of this title with a securities affiliate as defined in section 2(j) of the Bank Holding Company Act of 1956, as amended (12 U.S.C. 1841(j)).".

SEC. 11. Paragraph 1 of subsection 21(a) of the Banking Act of 1933, as amended (12 U.S.C. 378(a)(1)), is hereby amended by deleting the word "or" and replacing the semicolon at the end thereof with a period and by adding the following new sentence at the end thereof: "The prohibitions of this paragraph shall apply to any subsidiary (as defined in 12 U.S.C. 1841(d)) of any firm, corporation, association, business trust, or other similar organization engaged in the business of receiving deposits as described herein. A subsidiary of such organization, the activities of which become unlawful as a result of the enactment of the Depository Institutions Holding Company Act Amendments of 1983 may continue its existing activities for a period of two years after the date of enactment of such act; or".

SEC. 12. Section 32 of the Banking Act of 1933, as amended (12 U.S.C. 78), is hereby amended by adding the following sentence at the end thereof: "Notwithstanding any other provision of this section, an officer, director, or employee of any member bank may serve at the same time as an officer, director, or employee of any securities affiliates with which the member bank is affiliated. The term 'securities affiliate' shall have the meaning ascribed to it in section 2(j) of the Bank Holding Company Act of 1956, as amended (12 U.S.C. 1841(j)).".

AMENDMENTS TO THE FEDERAL DEPOSIT INSURANCE ACT

SEC. 13. Subsection 18(j) of the Federal Deposit Insurance Act (12 U.S.C. 1828(j)) is amended:

(1) by redesignating paragraphs (3) and (4) as paragraphs (4) and (5), respectively, and by adding the following new paragraph (3):

"(3) The provisions of section 20 of the Banking Act of 1933, as amended (12 U.S.C. 377), relating to affiliations between member banks and organizations engaged principally in certain securities activities, and the provisions of section 32 of the Banking Act of 1933, as amended (12 U.S.C. 78), relating to certain officer, director or employee relationships involving a member bank and a person or organization primarily engaged in certain securities activities, shall be applicable to every nonmember insured bank in the same manner and to the same extent as if such nonmember insured bank were a member bank. An affiliation or officer, director or employee relationship that becomes unlawful as a result of the enactment of this paragraph may continue for a period of two years after the date of enactment of this paragraph. The provisions of this paragraph shall not apply to any foreign bank, as defined in subsection 1(7) of the International Banking Act of 1978, having an insured branch in the United States with respect to any affiliation between such bank and any company organized under the laws of a foreign country that is not engaged in business in the United States except as an incident to its activities outside the United States, and shall not apply to any officer, director, or employee of any such foreign bank, but shall apply to officers and employees of the insured branch."; and

(2) by inserting after the words in the first sentence of paragraph (4)(A), as so redesignated under paragraph (1) of this section, "or any lawful regulations issued pursuant thereto," the following words: "or any provision of section 20 of the Banking Act of 1933, as amended,".

PROHIBITION ON CERTAIN ACTIVITIES BY DEPOSITORY INSTITUTIONS

SEC. 14. Section 2 of Public Law 93-100 (12 U.S.C. 1832) is amended by adding at the end thereof the following new subsection (d):

"(d) No State-chartered depository institution may commence, either directly or indirectly, any activity unless (1) such activity was authorized for that type of institution explicitly and not by implication by a State statute adopted, or by an interpretation promulgated thereunder, prior to January 1, 1983; (2) such activity is permitted under section 4(c)(8) of the Bank Holding Company Act for a bank holding company subject to all applicable limitations; or (3) such activity is explicitly authorized by a State statute, or interpretation promulgated thereunder, and is performed exclusively in the State authorizing such activity for residents of that State. This section does not authorize the conduct of any activity prohibited to a State-chartered depository institutions under sections 20 or 21 of the Glass-Steagall Act. Nothing in this section shall prohibit a State-chartered savings and loan association or savings bank from engaging in any activity expressly permitted for a Federal savings and loan association or Federal savings bank pursuant to the Garn-St Germain Depository Institutions Act of 1982 (Public Law 97-320). Any State-chartered depository institution that after

June 23, 1983, commenced any activity, directly or indirectly, that would have been prohibited by this subsection if commenced after enactment of this subsection shall immediately terminate such activity.".

AMENDMENTS TO THE SECURITIES ACT OF 1933

SEC. 15. Section 4 of the Securities Act of 1933, as amended (15 U.S.C. 77d), is hereby amended by adding a new paragraph (7) at the end thereof:

"(7) Transactions involving offers or sales of equity securities in connection with the acquisition of a bank by a company under the Bank Holding Company Act of 1956, as amended (12 U.S.C. 1841 et seq.), if such acquisition occurs solely as part of a reorganization in which a person or group of persons exchange their shares of a bank for shares of a newly formed bank holding company and receive, after such reorganization, substantially the same proportional share interest in the holding company as they held in the bank, except for changes in shareholder interests resulting from the exercise of dissenting shareholder rights under State or Federal law.".

AMENDMENTS TO THE SECURITIES EXCHANGE ACT

SEC. 16. Subparagraphs (i), (ii), and (iii) of paragraph (34)(A) of subsection 3(a) of the Securities Exchange Act of 1934, as amended (15 U.S.C. 78c(a)(34)(A)), are each hereby amended by inserting immediately before the semicolons at the end thereof, the words, "other than a securities affiliate as defined in section 2(j) of the Bank Holding Company Act of 1956, as amended (12 U.S.C. 1841(j)).

SEC. 17. Paragraph (b)(1) of section 15B of the Securities Exchange Act of 1934, as amended (15 U.S.C. 78o-4(b)(1)), is hereby amended by striking the word "subsidiaries" in parts (B) and (C) thereof and replacing it with the word, "affiliates".

AMENDMENTS TO THE FEDERAL RESERVE ACT

SEC. 18. (a) The Federal Reserve Act is amended by adding new section 23B immediately following section 23A (12 U.S.C. 371c) thereof to read as follows:

"SEC. 23B. RESTRICTIONS ON TRANSACTIONS WITH AFFILIATES.—(a) A member bank and its subsidiaries may engage in any of the following transactions, only on terms and under circumstances, including credit standards, that are substantially the same as, or at least as favorable to such bank or its subsidiary as those prevailing at the time for comparable transactions with or involving other nonaffiliated companies or, in the absence of comparable transactions, those terms and circumstances that in good faith would be offered to, or would apply to nonaffiliated companies:

"(1) any covered transaction, as defined in section 23A, with an affiliate;

"(2) the sale of securities or other assets, including assets subject to an agreement to repurchase, to an affiliate;

"(3) the payment of money or the furnishing of services to an affiliate, under contract, a lease, or otherwise;

"(4) any transaction in which an affiliate acts as an agent or broker or receives a fee for its services to the bank or any other person; or

"(5) any transaction or series of transactions with a third party, (A) if an affiliate has a financial interest in the third party, or (B) if an affiliate is a participant in such transaction or series of transactions.

For the purposes of this subsection, any transaction by a member bank with any person shall be deemed to be a transaction with an affiliate of such bank to the extent that the proceeds of the transaction are used for the benefit of, or transferred to, such affiliate.

"(b) A member bank and the affiliates of such bank shall not publish any advertisement or enter into any agreement stating or suggesting that the bank shall in any way be responsible for the obligations of its affiliates; however, a member bank and its affiliates may use similar names.

"(c) A member bank and any subsidiary of such bank:

"(1) shall not purchase as fiduciary any securities or other assets from any affiliate unless such purchases are permitted under the instrument creating the fiduciary relationship, by court order, or by law of the jurisdiction under which the trust is administered; and

"(2) whether acting as principal or fiduciary, shall not knowingly purchase or otherwise acquire, during the existence of any underwriting or selling syndicate, any security a principal underwriter of which is an affiliate of such bank; except that this prohibition shall not apply where the purchase of such securities has been approved, prior to the time at which such securities are initially offered for sale to the public, by a majority of the directors of the bank who are not officers or employees of the bank or any affiliate thereof. For the purpose of this paragraph, the term 'security' means a 'security' as defined in section 3(a)(10) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(12)); and the term 'principal underwriter' means any underwriter who, in connection with a primary distribution of securities, (A) is in privity of contract with the issuer or an affiliated person of the issuer; (B) acting alone or in concert with one or more persons, initiates or directs the formation of an underwriting syndicate; or (C) is allowed a rate of gross commission, spread, or other profit greater than the rate allowed another underwriter participating in the distribution.

"(d) For the purpose of this section:

"(1) the term 'affiliate' means an 'affiliate' as defined in section 23A of the Federal Reserve Act (12 U.S.C. 371c) excluding a bank; and

"(2) the terms 'bank', 'subsidiary', 'person', and 'security' (other than security as used in subsection (c)) have the same meanings given to them in section 23A of the Federal Reserve Act (12 U.S.C. 371c).

"(e) The Board may prescribe rules and regulations to administer and carry out the purposes of this section, including rules or regulations to (1) further define terms used in this section; (2) exempt transactions or relationships from the requirements of this section; or (3) exclude from the definition of 'affiliate' in this section any subsidiary of a bank holding company, if the Board finds such exemptions or exclusions to be in the public interest and consistent with the purposes of this section.".

(b) Section 18(j) of the Federal Deposit Insurance Act (12 U.S.C. 1828(j)) is hereby amended:

(1) by inserting "and section 23B" after "section 23A" at each place it appears in paragraph (1); and

(2) by inserting ", 23B," after "23A" in paragraph (4)(A), as so redesignated under paragraph (1) of section B of this Act.

AMENDMENTS TO THE INVESTMENT COMPANY AND INVESTMENT ADVISERS ACTS OF 1940

SEC. 19. (a) Subsection 17(f) of the Investment Company Act of 1940, as amended (15 U.S.C. 80a-17(f)), is hereby amended by adding after the words "unit investment trusts": "*Provided, however,* That any registered management company that is organized, sponsored, operated or controlled by, or which receives investment advice from, any securities affiliate, as defined in section 2(j) of the Bank Holding Company Act of 1956, as amended (12 U.S.C. 1841(j)), may place and maintain its securities and similar investments in the custody of a bank which is affiliated with such securities affiliate only with the prior approval of the Commission.".

(b) Subsection 26(a)(1) of the Investment Company Act of 1940, as amended (15 U.S.C. 80a-26(a)(1)), is hereby amended by adding after the words "so published);": "*Provided, however,* That, except with the prior approval of the Commission, it shall be unlawful for such trust indenture, agreement of custodianship, or other instrument to designate as trustee or custodian any bank which is affiliated with a securities affiliate, as defined in the Bank Holding Company Act of 1956, as amended (12 U.S.C. 1841(j)), which organizes, sponsors, operates or controls such registered unit investment trust.".

(c) Subsection 27(c)(2) of the Investment Company Act of 1940, as amended (15 U.S.C. 80a–27(c)(2)), is hereby amended by adding after the words "trust indentures of unit investment trusts": "*Provided, however,* That, except with the prior approval of the Commission, it shall be unlawful to deposit such proceeds with any bank which is affiliated with a securities affiliate, as defined in section 2(j) of the Bank Holding Company Act of 1956 as amended (12 U.S.C. 1841(j)), which organizes, sponsors, operates, controls or renders investment advice to such registered investment company.".

(d) Subsection 202(a)(11) of the Investment Advisers Act of 1940, as amended (15 U.S.C. 80b–2(a)(11)), is hereby amended by inserting after the words "bank holding company" the following: "(other than a bank holding company which is a securities affiliate)".

AMENDMENTS TO BANK HOLDING COMPANY ACT AMENDMENTS OF 1970

SEC. 20. Section 105 of the Bank Holding Company Act Amendments of 1970, (12 U.S.C. 1850), is hereby amended by deleting the words ", to engage directly or indirectly in a nonbanking activity pursuant to section 4 of such Act.".

SEC. 21. Section 106 of the Bank Holding Company Act Amendments of 1970 (12 U.S.C. 1972, et seq.), is hereby amended by adding new subsection (i) at the end thereof to read as follows:

"(i) Any action for injunctive relief that may be commenced by any person pursuant to section 1976 of this title may be commenced on the behalf of such person by any trade association of which such person is a member: *Provided*, That any such action commenced by a trade association shall be subject to the same requirements, limitations, and conditions as would be applicable had such action been commenced by any such person pursuant to section 1976 of this title.".

AMENDMENTS TO THE SAVINGS AND LOAN HOLDING COMPANY AMENDMENTS OF 1967

SEC. 22. Section 408 of the National Housing Act (12 U.S.C. 1730a), is hereby amended by deleting subsection (n) thereof and replacing it with the following new subsection (n):

"(n) In the event that (A) an insured institution that is owned or controlled by a unitary savings and loan holding company devotes less than 60 per centum of its assets to residential mortgages and related investments on average during the year; (B) such subsidiary insured institution's services or products are offered to or marketed through such holding company or its other subsidiaries; or (C) the services or products of such holding company or its other subsidiaries are offered to or marketed through such subsidiary insured institution, such unitary savings and loan holding company may not thereafter commence, or continue for more than three years, any business activity not permissible for a multiple savings and loan holding company under paragraph (2) of this subsection. For purposes of determining compliance with the three-year period described in the preceding sentence, the last sentence of paragraph (2) of this subsection shall be inapplicable. For the purposes of this section, the term "related investments" means (i) securities backed by residential mortgages; (ii) retail mobile home loans; (iii) home improvement loans; (iv) loans to finance the construction of residential properties; and (v) investments in service corporations except that such investments shall be reduced by an amount proportionate to the amount of such corporation's assets that are not residential mortgages or related investments as defined in this section.".

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The CHAIRMAN. We welcome today a distinguished panel of witnesses from six national banking organizations. The written statements that you have prepared are very thorough and we will certainly include your full statements in the record and ask you to summarize them. We look forward to your testimony.

Senator Proxmire.

OPENING STATEMENT OF SENATOR PROXMIRE

Senator PROXMIRE. Mr. Chairman, I welcome the chance to take part in these important hearings on legislation to restructure our financial services industry.

The bills before us include your bill, S. 2181, and the bill I've introduced, S. 2134. Both bills deal with the future structure of our financial services industry. The two existing laws that shape our financial structure are the Bank Holding Company Act and the Glass-Steagall Act. The central purpose of both of these laws is to separate the business of banking from other commercial and financial endeavors so as to insure a safe and sound banking system, to prevent conflicts of interest, and to avoid the concentration of financial power.

I believe these objectives were valid when they were enacted and I think they remain valid today and I am not happy that they are being eroded almost daily, partly by clever attorneys exploiting loopholes in the law, partly by some State legislatures who have come to look upon liberalized banking laws as a means of attracting out-of-State banks to their State, and partly by Federal regulators who have the tendency to impose their own philosophies on the laws they disagree with.

The time has clearly come for the Congress to assert its authority over the shape and structure of our financial system. Congress passed the Glass-Steagall Act and the Bank Holding Company Act only after the most lengthy and careful consideration. We cannot sit idly by while these laws are being stripped of their meaning. Congress made the laws and only the Congress can unmake them, if they are to be undone.

If the Glass-Steagall and Bank Holding Company Acts are obsolete, they should be repealed by the Congress. If they remain valid, existing loopholes should be closed, or if changes are needed, they should be enacted. But one way or another, Congress needs to act and act promptly.

Putting this issue over until next year would be an irresponsible copout. I am, therefore, strongly behind your efforts to bring these bills before the committee following our hearings. I believe the prospects are good for passing a bill this year to close some of the more gaping loopholes in our banking laws while at the same time providing bank holding companies with modest new powers to enhance their abilities to compete in today's rapidly changing environment.

I think Chairman Paul Volcker has made an accurate assessment when he observed that there seemed to be an emerging consensus on a core bill for shoring up our present laws while continuing the deregulatory initiatives taken in the last two Congresses.

So I hope these hearings can help to build upon that consensus and the committee will be called together shortly after completion of the hearings to consider the legislative issues before us.

The CHAIRMAN. Thank you, Senator Proxmire. Although we may have some small differences of opinion on what direction we want to go, there is certainly no difference between Senator Proxmire and I on the need to take action and not continue to delay.

Senator Armstrong, do you wish to make any comment?

OPENING REMARKS OF SENATOR ARMSTRONG

Senator ARMSTRONG. No, Mr. Chairman, I really don't, other than to endorse the sense of urgency which you and Senator Proxmire have already expressed.

Over the last several weeks I have been meeting privately with leaders of the financial services industry, including some of those who are scheduled to testify here today, and I am particularly looking forward to what we are going to elicit in today's testimony and in the several weeks to come.

On a personal note, Mr. Chairman, I'm especially glad to welcome a very old friend of mine from Colorado, Bill Nicholson, who has been an adviser to me during the years when I was in the State legislature. In fact I served with his father who was one of our most distinguished legislators and a former mayor of Denver, and a person who has shown very special leadership in the banking community in my own home State of Colorado.

I know some of the other members of the panel and I am glad to join you and the others in welcoming them here today. We're looking forward to your testimony, gentlemen.

The CHAIRMAN. Thank you, Senator Armstrong.

Senator Hecht.

OPENING STATEMENT OF SENATOR HECHT

Senator HECHT. Thank you, Mr. Chairman.

During these past 12 months we have seen America turn the corner and begin the long process of economic restoration. The economy is growing again. Inflation has been tamed and people across the Nation are returning to work. Our strength has been renewed and our Nation is once again looked on as a strong leader of the free world.

This coming year we in Congress will have to face up to the serious responsibility of assuring a sustained recovery. I feel quite strongly that the issues before us on the Banking Committee will play a critical role in this endeavor. I compliment Chairman Garn for having the courage to bring these issues of financial institution deregulation to the forefront.

These measures we have before us could evolve into the most important economic legislation of the 98th Congress. The ramifications of our actions and indeed our inaction are many and broad based. We are analyzing the last 50 years and looking forward to the next 50 years.

Before coming to the Senate last year I was a businessman for 35 years in Nevada. For 20 of those years I was involved in a successful banking operation. Additionally, I was a retailer. In short, I came from the business world, sharing many of the same responsibilities and experiences as many of the witnesses we will have before us during these hearings.

I certainly do not adhere to the long-winded approach to governing. However, because of the serious and far-reaching implication of what we are about to undertake, we must proceed in an orderly, thoughtful, and deliberate manner. We simply cannot afford to make a mistake in judgment at this critical time.

My main concerns during these hearings will focus on the following points. Will the small entrepreneur still be served in a deregulated environment or will they be neglected for the more attractive and lucrative ventures? What has broken that needs fixing? Is a major overhaul of the current statute or minor adjustments the answer? Are the fears of bank concentration hollow ones? Will the banking industry in America soon resemble the European and Canadian systems? What will the business environment be should the entire deregulation package be enacted? Will our free enterprise system be enhanced or weakened?

Let us look at our current environment. Car sales are at record levels. Home sales continue to soar. Retail sales remain high. Corporate profits in the United States during the last quarter were incredible and, lo and behold, bank earnings are up. Again I ask, what is broken that needs fixing?

I have pledged that I will assist Chairman Garn in working toward a timely completion of our task. We will be conducting several hearings over the next few weeks and I intend to be a regular attendee.

Thank you.

The CHAIRMAN. Thank you.

Senator Sasser.

Senator SASSER. Mr. Chairman, I don't have an opening statement. I do want to commend you, Mr. Chairman, for moving forward with these hearings on a matter that I think is of great importance to the economic health of the Nation and I look forward to hearing today this distinguished panel.

The CHAIRMAN. Senator Humphrey.

Senator HUMPHREY. No statement.

The CHAIRMAN. Senator Heinz.

OPENING REMARKS OF SENATOR HEINZ

Senator HEINZ. Mr. Chairman, I would like to have made an opening statement, but we have had these fine witnesses before us so many times over the last three sessions of Congress, I would just be redundant if I made my opening statement over again.

It almost reminds me a little bit of Washington's cherry trees, which perennially bloom. There is always, as there is today, an overflow crowd. There is tremendous interest, and I, of course, would subscribe to the comments of many here that there are much more weighty issues involved here than cherry trees. We want to be sure that if we're going to cut any of them down that we know why we are doing it and we want the most fruitful and accurate testimony.

It is not at all clear—and I think this panel and subsequent panels may help us in this regard—whether, like Washington's cherry trees, we are going to produce legislation or not. Washington's cherry trees are fruitless. I don't know whether these hearings are going to be fruitless or not. Whether they bear fruit in the form of legislation really depends on all our witnesses. Whether that legislation is major, minor, or nonexistent will depend, I think, on what we learn.

I have found, Mr. Chairman, if I may commend you, that although it gets harder and harder to make an opening statement, I think each time we have had the opportunity to address these issues that we get better at understanding the issues, better at asking the right questions, better at focusing in on the real issues.

I would only make one other comment and in a sense I suppose it echoes what Senator Hecht said a minute ago. What we are really looking for here in any financial services legislation—and we've had two very major bills in the last two Congresses, the 1980 Monetary Control Act and the 1982 Garn-St Germain Act—is we are looking for policies that will validly serve the public. Senator Hecht says that we want to be sure that we know what is broken before we fix it. I would flip that coin over and say that we want a very strong argument that whatever it is that we're doing it is not just to satisfy the special pleadings of one group, whether they be bankers, or insurance agents, or realtors, or savings and loan associations, or you name it. We don't want to try and just accommodate the special pleadings of special interests.

What we want is to accommodate the public interest of the consumer. We need to be very explicit about exactly how any policy is indeed going to benefit those people out there, whether they're in Pittsburgh or Punxautawney in my home State, and why any proposals that you or any of the other people are going to have—Lord knows we're going to have enough of them—is really in the public interest.

Mr. Chairman, thank you.

The CHAIRMAN. Let me make one comment about the crowd here. I would note another advantage to field hearings. In Salt Lake City we had a room that was probably three times as big, had more than twice as many people, all of them seated on comfortable chairs with carpet under their feet. To those lobbyists who flew to Salt Lake City from Washington, we appreciate your business for our airlines, for our hotels, the food you ate, and those of you who stayed over to ski we also appreciated that revenue. And so I think it was a net gain for Salt Lake City because the testimony was good, and our economy benefited from the Washington lobbyists who journeyed there to attend the hearings. I'm sorry they lasted until 6 o'clock and they didn't get up for afternoon skiing.

Senator HEINZ. If I may say so, Mr. Chairman, your invitation to ski was a real snow job.

The CHAIRMAN. We have plenty of snow out there this year.

Gentlemen, we are happy to have you with us. Our panel today is consisting of Mark Olsen, president of Security State Bank, Fergus Falls, Minn., chairman of the Government Relations Council of the American Bankers Association; A. Jack King, president of Valley Bank, Kalispell, Mont., second vice president of the Independent Bankers Association of America; Will F. Nicholson, Jr., president of Colorado National Bancshares, Inc., of Denver, Colo., chairman of the Association of Bank Holding Companies; Charles Pistor, chairman of the board, Republic Bank, Dallas, Tex., past chairman of government relations of the Association of Reserve City Bankers; Frederick S. Hammer, executive vice president, Chase Manhattan Bank of New York, past chairman of government relations and chairman elect of Consumer Bankers Association; and Richard P. Patterson, senior vice president of the InterFirst Bank, Dallas, Tex., president of the Dealer Bank Association.

Gentlemen, we are happy to have you with us. Mr. Olsen, if you would like to begin.

STATEMENT OF MARK OLSEN, PRESIDENT, SECURITY STATE BANK, FERGUS FALLS, MINN; CHAIRMAN, GOVERNMENT RELATIONS COUNCIL, AMERICAN BANKERS ASSOCIATION

Mr. OLSEN. Thank you, Mr. Chairman.

Mr. Chairman and members of the committee, I am Mark Olsen, president of the Security State Bank of Fergus Falls, Minn., and chairman of the Government Relations Council of the American Bankers Association. The combined assets of our nearly 13,000 member banks represent approximately 95 percent of the industry total. While our members range in size from the smallest to the largest banks, approximately 90 percent of them have assets of less than $100 million.

NEED TO KEEP FINANCIAL SERVICES INDUSTRY HEALTHY

At the outset, I would like to commend the chairman for his leadership role in focusing attention on the need to make the statutory and regulatory framework of the financial services industry more rational. While the task before this committee is a particularly difficult one, its importance cannot be overemphasized. A healthy, competitive financial services industry is an integral part of a healthy, competitive economy.

This committee is well aware of the dramatic changes that have occurred in financial services markets in recent years.

It is widely assumed—and wrongly assumed—that the changing financial marketplace is of concern only in big cities like New York, Chicago, and San Francisco.

Allow me to describe the competitive environment of my home town—the place where I run a bank.

Fergus Falls is a community of 14,000 persons. In our trade area, we have a population of about 50,000. We are 50 miles from the nearest standard metropolitan statistical area.

But, Mr. Chairman and members of this committee, let's look at the nonbank competition I face. If I may say so Senator Heinz, your analogy to the cherry trees is apt. Cherry picking is very much an issue in the financial services industry. The nonbank competitors that come into town are not finding our trees fruitless. Let me elaborate.

There are two investment firms, both of which have offered money market mutual funds and federally insured deposits.

There are several life insurance agents offering money market mutual funds.

There are two real estate firms operating under nationwide franchises and one of these firms offers a mortgage loan package as part of its marketing strategy.

All of these nonbank competitors are within a 10-minute walk from my bank.

Furthermore, cable TV franchises carry advertisements from major nonbank financial institutions located throughout the country, drawing much needed capital from my community.

There is a J. C. Penney down the road and a Sears outlet is less than an hour's drive away.

Five years ago, the investment firms did not offer insured deposits.

Five years ago, the real estate people wouldn't have dreamed of offering mortgage loans.

Five years ago, the insurance companies did not offer money market mutual funds, Penneys was small change and the only stock you could buy at Sears was the kind that fitted onto a hunting rifle.

With all that in mind, I guess it is no surprise to you that I am here today to talk about the urgency of granting banking new opportunities to serve our customers through new products and services.

Small banks, medium-size banks, and large banks are all together on this one.

I don't fear, we don't fear, the nonbank competition.

Indeed, we want to come to grips with that competition.

But, we do fear that if we are not allowed to come to grips with the competition soon, we will be forced to manage the decline of our industry. If this decline is allowed to happen, the public interest will be harmed directly.

I don't need to remind you that the bank is the local institution in communities all across the Nation that finances local businesses through local deposits and gives the community direct access to the payments system. This is what I sincerely believe is currently in jeopardy.

The banking system keeps the economy rolling.

In my official role at the ABA, I attend banking forums all across the country. In every one I've been to over the last year bankers talk about one thing: Their urgent need for competitive opportunities.

Really, it all comes down to five questions: What is a bank? Who is allowed to own a bank? What products and services should banks be allowed to offer? Where should banks be allowed to offer these services? How will banking be regulated in the future?

Just last Friday, our ABA Banking Leadership Conference—our policymaking body of 400 bankers—came to a consensus on expanding financial product and service opportunities for banks.

We agreed that: The American people and our Nation's economy need a new, dynamic, competitive banking structure designed to meet current and future public needs without the encumbrance of outdated prohibitions on the products and services banks may offer.

Thus, we strongly urge the Congress, during the current session, to authorize banks to offer the new products and services proposed in pending legislation in the fields of real estate, insurance and securities, including the underwriting of mortgage-backed securities, and such other financial products as may be approved by the regulators.

The Banking Leadership Conference again endorses the proposed redefinition of a bank supported by the administration and the Federal Reserve. A bank, for the purposes of the Bank Holding Company Act, should be strictly defined as: (1) An FDIC-insured institution; (2) any institution eligible to be FDIC insured; or (3) any institution that accepts deposits that the depositor may withdraw by check or similar means for payment to third parties and is engaged in the business of making commercial loans. Once that legal redefinition is enacted, any entity willing to live by the legislative and regulatory rules governing banking should be allowed to own a bank. As proposed in the legislation, savings and loans are excluded from this redefinition because they would be similarly defined and regulated by the Savings and Loan Holding Company Act.

A fundamental and unique responsibility of a bank is the provision of payment of services. Direct access to the ultimate settlement mechanism—Federal Reserve accounts—is an essential characteristic of this responsibility. Other types of organizations gaining direct access to the payments system should meet the definition of a bank and be subjected to the same rules.

GRANT BANKS AUTHORITY TO OFFER NEW PRODUCTS AND SERVICES

The banking community applauds the efforts of the administration, Senate Banking Committee Chairman Jake Garn, and ranking minority member William Proxmire to spark congressional interest in and consideration of reshaping the financial services marketplace and in granting banking organizations the authority to offer new products and services. The banking community calls on Congress to grant banking, without discriminatory restrictions, all the financial services options necessary for it to remain competitive in meeting the needs of the public. Restrictions such as a 5-percent-of-capital cap on real estate investments are arbitrary and discriminatory against banks; these restrictions should be liberalized very substantially.

The banking leaders note the growing importance of two other major questions: where banks should be allowed to operate and who will regulate banking in the future? However, they conclude that these matters should not be considered until after resolution of the questions of what is a bank, who should be allowed to own one, and what products and services banks should be allowed to offer.

Opponents to granting banks new products and services—new competitive opportunities—use many arguments: safety and soundness, fiduciary responsibility, tie-ins, concentration of power, access to low-cost funds, and tax and regulatory advantages that they claim banks enjoy. We have dealt with—and I believe successfully refuted—these arguments in our written testimony. My colleagues here today will discuss the details.

But, Mr. Chairman and members of the committee, the point I want to stress is that if our customers don't want new products and services from banks, the markets will tell us. That is the American way. It should not be the decision of Government fiat.

These opponents are our competitors. They now function in protected markets; certainly it is to their advantage to keep banks out. Each of their arguments, however, has been couched in more lofty terms of protecting the public. America's bankers on the other hand believe that the public interest, and the consumer, will clearly be best served by increased competition in the financial services industry. Our written testimony explains how.

Our nonbank opponents are now in the business of banking. Banking is excluded from their businesses of a financial nature. The question that you must ask yourselves as lawmakers is how to justify this contradiction. We believe there is no way to justify it.

Thank you.

[The complete statement follows:]

STATEMENT

OF

MARK W. OLSON

on behalf of

THE AMERICAN BANKERS ASSOCIATION

Mr. Chairman and members of the Committee, I am Mark W. Olson, President of the Security State Bank in Fergus Falls, Minnesota, and Chairman of the Government Relations Council of the American Bankers Association. The combined assets of our nearly 13,000 member banks represent approximately 95 percent of the industry total. While our members range in size from the smallest to the largest banks, approximately 90 percent of them have assets of less than $100 million.

At the outset, I would like to commend the Chairman for his foresight in holding preliminary oversight hearings last spring, and for his current leadership role in focusing attention on the need to rationalize the existing statutory and regulatory framework of the financial services industry. While the task before this Committee is a particularly difficult one, its importance cannot be overemphasized. A healthy, competitive financial services industry is an integral part of a healthy, competitive economy.

This Committee has been instrumental in bringing about significant improvements in the ability of financial institutions to serve their customers. In particular, the Garn-St Germain Depository Institutions Act of 1982 put the deregulation of deposit interest rates back on track. We believe there is an urgent need to take the next step in modernizing our financial institutions — allowing depository institutions to better serve their customers by offering a broader range of products and services. Three of the proposals currently before this Committee focus on this important issue -- S. 1609 introduced by Senators Garn and Proxmire at the request of the Treasury, S. 2134 introduced by Senator Proxmire, and S. 2181, introduced by Senator Garn. Most of my comments will relate to these three bills.

Representatives of all segments of the banking industry met in Washington last week under the auspices of ABA's Banking Leadership Conference to discuss the major issues raised by this legislation. That group adopted the following statement relative to the fundamental issues before the Committee:

Banking Leadership Consensus On Expanding Financial Product and Service Opportunities for Banks

The American people and our nation's economy need a new, dynamic, competitive banking structure designed to meet current and future public needs without the encumbrance of outdated prohibitions on the products and services banks may offer.

Thus, we strongly urge the Congress, during the current session, to authorize banks to offer the new products and services proposed in pending legislation in the fields of real estate, insurance and securities, including the underwriting of mortgage-backed securities, and such other financial products as may be approved by the regulators.

The Banking Leadership Conference again endorses the proposed redefinition of a bank supported by the Adminstration and the Federal Reserve. A bank, for the purposes of the Bank Holding Company Act, should be strictly defined as: 1) an FDIC insured institution; 2) any institution eligible to be FDIC insured; or 3) any institution that accepts deposits that the depositor may withdraw by check or similar means for payment to third parties and is engaged in the business of making commercial loans. Once that legal redefinition is enacted, any entity willing to live by the legislative and regulatory rules governing banking should be allowed to own a bank. As proposed in the legislation, savings and loans are excluded from this redefinition because they would be similarly defined and regulated by the Savings and Loan Holding Company Act.

A fundamental and unique responsibility of a bank is the provision of payment services. Direct access to the ultimate settlement mechanism (Federal Reserve Accounts) is an essential characteristic of this responsibility. Other types of organizations gaining direct access to the payments system should meet the definition of a bank and be subjected to the same rules.

The banking community applauds the efforts of the Administration, Senate Banking Committee Chairman Jake Garn and Ranking Minority Member William Proxmire to spark Congressional interest in and consideration of reshaping the financial services marketplace and in granting banking organizations the authority to offer new products and services. The banking community calls on Congress to grant banking, without discriminatory restrictions, all the financial services options necessary for it to remain competitive in meeting the needs of the public. Restrictions such as a five-percent-of-capital cap on real estate investments, a restriction which is arbitrary and discriminatory against banks; this cap should be liberalized very substantially.

The banking leaders note the growing importance of two other major questions: where banks should be allowed to operate and who will regulate banking in the future. However, they conclude that these matters should not be considered until after resolution of the questions of what is a bank, who should be allowed to own one and what products and services banks should be allowed to offer.

Products and Services: General Discussion

This Committee is aware of the dramatic changes that have occurred in financial services markets in recent years. In our testimony before this Committee last spring, we described how high and volatile interest rates and significant demographic shifts have changed the financial service needs of both consumers and businesses. We also described how the ability of financial institutions to meet these needs has been enhanced as a result of changes in technology, particularly the technology used in communications and data processing.

Expansion of the products and services that banks are allowed to offer continues to be the top legislative objective of the American Bankers Association. Last spring we described why we believed that the original Administration - Treasury proposal to expand the services offered by banks would provide important public benefits. As I will discuss in more detail later, the ABA believes that the basic principles underlying the provisions on expanded products and services in the revised Administration - Treasury bill (S. 1609) and in the Garn bill (S. 2181) will also provide significant public benefits. In particular, the expansion of bank services and the simplified process of regulatory approval for banks entering approved areas will benefit consumers and enhance the competitive environment. Expansion of bank services through the bank holding company vehicle ensures preservation of the safety and soundness of our banking system, a major economic policy goal. The principle of functional regulation will enhance the competitive environment by insuring that all financial institutions compete under the same rules.

Let me elaborate on why we believe that expansion of the products and services that depository institutions are allowed to offer will benefit consumers. We believe significant consumer benefits will flow from a system in which each financial institution — depository institutions, insurance companies, securities firms, real estate firms, investment companies — can offer those products which best meet their customers' needs. The ability to conduct a wider variety of financial transactions in one location will certainly increase consumer convenience. Moreover, a single financial institution will be able to provide customers with information about the whole range of their borrowing and investment opportunities. This will enable customers to make better informed decisions in managing their finances.

In addition to the increased convenience of being able to conduct various types of financial business in one location, the services themselves may be less expensive. The increased competition resulting from securities, real estate and insurance firms being able to offer banking services and banks being able to offer securities, real estate, and insurance services will tend to push prices down and provide consumers with more alternatives and better service. Financial institutions may also be able to produce these services at a lower cost because they can spread fixed overhead across a larger number of activities. Competition will ensure that these cost savings are passed along to the consumer.

It is difficult to quantify these benefits. Nevertheless, a large number of nondeposit and nonfinancial institutions are rushing to provide their customers a full range of financial services. Obviously, the market believes that customers will respond favorably to the opportunity to meet most of their financial service needs at a single location with a single institution.

We are aware that our competitors — many of whom are already offering bank-type products either through the nonbank bank loophole or such close substitutes as money market funds/cash management accounts — will argue that allowing banks to offer new products and services represents the ultimate evil.

I would like to discuss some of these arguments in a general way before examining the specific provisions of each bill. We have divided the arguments into six categories: safety and soundness, fiduciary responsibility, tie-ins, concentration of power, access to low cost funds, and tax and regulatory advantages.

Safety and Soundness

Perhaps the argument most often cited by opponents of expanded bank products concern the safety and soundness of the banking system. Frequently the spector of the Depression and the numerous bank failures of the 1930's is raised as proof of the tremendous dangers of allowing banks to diversify their services, especially into the securities industry. There are three general categories of hazards alleged to pose a threat to safety and soundness if banks are allowed to offer expanded products and services.

First, it is charged that a bank with a securities subsidiary may make unsound loans either to its subsidiary, to a company whose securities in which the subsidiary deals, or to a customer to purchase securities in which the subsidiary deals. The question here is not whether banks will ever make some bad loans; obviously they will. Indeed, a banking system with no loan losses would not be desirable in an entrepreneurial economy. The question is whether bank entry into new products and services through a holding company subsidiary expose the banking industry to a significantly greater degree of risk than it faces now.

Some have alleged that the securities activities of banks were primarily responsible for the bank failures of the 1930's. Historical evidence contradicts this assertion. Most banks which specialized in providing investment banking services in the 1920's and early 1930's survived the

Depression. The overwhelming majority of bank failures was among small unit banks, generally in agricultural states. This certainly casts doubt on the allegation that history proves expanded products and services will lead to unsafe banking practices.

More important, however, are the legislative and regulatory changes that have taken place since the 1930's which have altered the environment so dramatically as to make any conclusions drawn from the Depression experience irrelevant. Of particular importance to the current discussion is Section 23A of the Federal Reserve Act which severely limits the transactions between banks and their affiliates, both in the amount of loans and in the collateral required. Among other significant regulatory changes are increased supervision stemming from FDIC insurance, cease and desist powers, increased disclosure, and improved supervisory methods. In addition, there have been many changes in securities laws which have stabilized securities markets by regulating the participants in those markets.

The second safety and soundness issue raised by opponents of expanded bank products and services is that if a bank affiliate gets into trouble, the public may lose confidence in the bank itself, thus increasing the risk of bank failure. Recent history, including the well publicized problems of some banks with Real Estate Investment Trusts in the mid 1970's and the problems of the thrift industry in 1981-82, indicates that federal deposit insurance programs and federal agencies as lenders of last resort are sufficient to maintain public confidence.

The third allegation is that some lines of business that banks would like to enter are inherently more risky than traditional banking activities and would therefore increase the riskiness of the banking industry. I know of no empirical evidence which suggests that these new activities are any riskier than the current activities undertaken by banks. In fact, the nature of these services suggest they may be no riskier or even less risky than current bank activities.

Most of the allegations of increased risk center on securities and real estate equity activities. Under the current proposal, banks would be allowed to underwrite state and local revenue bonds. This is no riskier than underwriting general obligation bonds which banks already do. Banks would also be allowed to sponsor and sell mutual funds. Opponents of bank expansion into mutual funds conveniently overlook the fact that increases and decreases in the value of such funds do not affect the sponsor's balance sheet. Moreover, sponsoring and selling mutual funds is similar to other activities which many banks already undertake within their trust operations.

Changes in the value of real estate can produce losses and gains for a bank if it holds real estate equity positions. However, declines in real estate values already produce losses for the bank when its real estate loans are not repaid. Increases in the value of real estate do not produce gains for banks that hold real estate loans, but they would produce gains if banks could hold real estate equity.

Even if a bank were to incur losses in one of these new activities, the current legislative proposals would minimize the impact of such losses on the bank by segregating these activities in separate subsidiaries of the holding company. We believe that the concept of corporate separateness will ensure that any difficulties encountered by one corporation cannot be passed along to an affiliated corporation. Attachment 1 is a paper recently done for ABA by Sam Chase and Donn Waage entitled "Corporate Separateness as a Tool of Bank Regulation". As the authors point out, there is no reason to doubt that the principle of corporate separateness is workable in shaping a new regulatory strategy. The authors also conclude that the legal and regulatory restrictions as well as supervisory practices mentioned above will guard against the diversion of bank resources to help a troubled affiliate.

Violation of Fiduciary Responsibility

Opponents of expanded bank products also allege that a bank securities affiliate may unload low quality securities on the bank's trust department. Here again, opponents point to practices in the 1920's and 1930's as evidence that such dangers exist. Whether or not such abuses did indeed occur, it is clear that today's regulatory practices would preclude such transactions. Trust departments are prohibited from any kind of self-dealing by detailed regulations of the banking agencies, the Municipal Securities Rulemaking Board, and the Securities and Exchange Commission. Moreover, it is in the best interest of the bank and its trust department to protect its reputation. Unloading low quality securities on a bank trust department or any similar practice will reduce the return to the bank's trust accounts. Since managing trust accounts is a competitive business, a bank trust department which shows a poor return on its trust accounts will not be able to retain its customers.

I would like to add another thought on the general subject of conflicts of interest. A conflict of interest is a conflict between the private interests and the official responsibilities of a person in a position of trust. Conflict of interest situations are pervasive in all aspects of life -- certainly they are not unique to banking. For example, if there is a potential conflict of interest between commercial lending decisions and securities underwriting as alleged by our opponents, certainly such conflicts also exist when insurance companies -- which lend significant amounts to corporations -- are affiliated with securities firms. Eliminating all conflicts of interest is not possible or desirable; what is necessary is to assure that we have laws and regulations to prevent misconduct stemming from such conflicts. In the banking field, we believe that legislation and regulations are adequate.

Tie-In Sales

Perhaps the favorite claim of unfair competition is that banks can use their unique position as lenders to pressure customers into buying other bank services. This pressure may be implicit, opponents say, but it cannot be avoided except by preventing bank holding companies from offering additional products and services.

Tie-in sales are prohibited by law, and there is no significant evidence to indicate that banks have been able to evade this law. In addition to the legal prohibition, tie-in sales imply a monopoly power on the part of the lender that does not exist. Quite simply, competition precludes tie-in arrangements. Moreover, the consumer will benefit both from the increased convenience of being able to conduct several types of financial business in one trip, and the increased competition among providers of financial services. Prohibiting banks from offering new products and services because of the possibility that a bank customer might assume that the purchase of a product from a bank affiliate will some how improve his status for credit approval would unnecessarily deny these consumer benefits.

Concentration of Economic Power

Opponents of the expansion of depository institution powers frequently capitalize on the common nebulous fear that big is bad. Allowing banks to expand into new areas, they allege, will allow banks to wield excessive economic power; they will drive out smaller competitors leading to monopoly power. This is a difficult argument to analyze because its appeal is primarily emotional rather than factual. There are over 14,000 banks in this country; as we stated at the beginning of our testimony, some 90 percent of these are community banks with assets of less than $100 million. California provides a good example of very large banks sharing a market with many small banks and thrifts. This co-existence of many small banks with larger regional and money center banks indicates that there are no significant economies of scale in banking. If significant economies of scale are not present, large firms cannot drive small efficient firms out of the market.

According to a Federal Reserve Board study published in the Federal Reserve Bulletin in February 1982, concentration of banking resources declined between 1969 and 1980. At the national level, for example, the proportion of domestic deposits held by the ten largest banking organizations fell from 20.2 percent in December 1969 to 17.9 percent in December 1980. Domestic deposits of the 100 largest banking organizations declined from 47.3 percent in 1969 to 45.4 percent in 1980. The same trend toward decreasing concentration was found using Standard Metropolitan Statistical Areas to approximate local banking markets.

At least two of the markets which the proposed legislation would permit banks to enter are more concentrated than commercial banking. For example, in the securities brokerage industry, 16 percent of the firms account for 92 percent of total industry assets. By contrast, it would take 35 percent of the nation's banking organizations to account for 92 percent of domestic banking assets. The top ten life insurance companies account for 51.5 percent of the total assets of the industry, vis-a-vis 21.7 percent for the ten largest banking organizations. Rather than leading to increased concentration, allowing banks to enter these markets will increase both actual and potential competition.

Access to Low Cost Funds

Opponents of expanded products and services claim that banks have an unfair advantage over nonbanks because federal deposit insurance and the discount window give banks access to below market rate funds. These opponents tend to ignore the fact that deposit insurance and the discount window are not costless to the bank. Banks pay deposit insurance premiums, hold non-interest bearing reserves imposed by the Federal Reserve for monetary policy purposes, and are closely regulated and supervised to reduce risk.

Perhaps the most persuasive rebuttal of this argument is to look at those markets where banks and nonbanks currently compete. For example, both banks and securities firms underwrite state and local general obligation bonds. Of the 10 leading underwriters in 1982, only 4 were banks; only 11 out of the top 30 were banks. The same is true in other areas where banks and nonbanks compete, such as mortgage banking and consumer credit. As of year end 1982, only 13 of the 25 largest mortgage companies were bank affiliates. This certainly does not indicate that banks can drive out nonbank competitors.

The current legislation also includes provisions to insure that banks do not undertake transactions with their affiliates on terms that are less favorable to the bank than transactions with independent companies. Thus, if deposit insurance or access to the discount window allowed banks to acquire funds at a lower cost than other types of financial institutions, they would have to pass those benefits along to any independent companies to which they lend as well as to their affiliates.

Tax and Regulatory Advantages

Opponents of expanded bank products, especially the securities industry, have alleged that banks have an unfair advantage because they have a more favorable tax treatment and less strict regulations. The proposals under consideration by this Committee would permit bank expansion into new products and services to occur only through a bank holding company affiliate. Under the principle of functional regulation embodied in the proposals before this Committee and supported by ABA, bank securities affiliates will be regulated and taxed just like a securities firm, bank insurance affiliates will be regulated and taxed like an insurance firm, etc.

In this brief discussion and in the more detailed analysis to follow, we have addressed each of the issues raised by our competitors. These competitors now function in protected markets; certainly it is to their advantage to keep banks out. Each of their arguments, however, has been couched in more lofty terms of protecting the public. We believe that the public interest will be best served by increased competition in the financial services industry.

The remainder of our testimony will present a more detailed analysis of the specific issues raised by the legislative proposals before this Committee, starting with expanded powers and services. To facilitate presentation, we have divided our detailed analysis into major issues as follows:

	Issue	Related Bills	Page No.
1.	New products and services	S. 1609, S. 2134, S. 2181	13
2.	Formation of a bank holding company	S. 1609, S. 2134, S. 2181	38
3.	Procedure to engage in nonbanking activity	S. 1609, S. 2134, S. 2181	40
4.	Nonbank activity supervision	S. 1609, S. 2134, S. 2181	43
5.	Definition of a bank	S. 1609, S. 2134, S. 2181	44
6.	Thrift regulation	S. 1609, S. 2134, S. 2181	48
7.	Payment of interest on reserves	S. 2181	51
8.	Usury preemption	S. 2181	53
9.	Interest on demand deposits	S. 2181	58
10.	Credit and debit card fraud	S. 2181	61
11.	Consumer leasing and rental purchase agreements	S. 2181	64
12.	Delayed funds availability	S. 2181	73
13.	Bankers banks	S. 2181	82
14.	Interstate banking	S. 2107, S. 2113, S. 2181	83

1. New Products and Services

General Authority for Federal Reserve to Permit New Activities

In expanding the authority for bank holding companies to engage in nonbanking activities, S. 1609 and S. 2181 would authorize bank holding companies to engage in any nonbanking activity that the Board of Governors of the Federal Reserve System finds, by order or regulation, to be closely related to banking, or any activity that the Board finds by regulation to be of a financial nature. This redefinition of appropriate nonbanking activities for bank holding companies is essential to the continued strength and stability of the banking industry.

The existing language of Section 4(c)(8) of the Bank Holding Company Act requires that the Board of Governors find that an activity is so closely related to banking as to be a proper incident thereto before it may approve that activity for bank holding companies. Unfortunately, this language has not proved sufficiently flexible to allow the Board of Governors the discretion to maintain the approved list of bank holding company nonbanking activities current with marketplace developments. The pace at which technology is changing and, more importantly, the implementation of these technological changes in the financial services industry in recent years, has been nothing short of spectacular. It is only through the use of recently available technology that money market mutual funds, money brokers, and such market innovations as the cash management account have been able to make major inroads into the traditional markets for financial services. Banks have been no less innovative than their competitors in seeking to make use of technology. However, the existing language of the Bank Holding Company Act, and even more restrictive interpretations of that language, have hampered banks from using technology to improve the delivery of products and services to their customers.

These constraints have served neither the consumer nor the banking industry. In fact, it is largely because of the restraints of the existing language of the Bank Holding Company Act that banks have been forced to attempt to recover the increases in costs resulting from deposit rate deregulation by concentrating on increasing fees for the delivery of pure banking services rather than being able to seek out new profit opportunities in related financial services.

Our Association would therefore strongly support the revised language contained in S. 1609 and S. 2181 that would authorize bank holding companies to engage in any activity found to be of a financial nature or to be closely related to banking. This change in language will allow the Board of Governors to continue to be responsive to market developments in authorizing bank holding companies to be among the forefront in using technology to deliver new products and services more efficiently and competitively to the consuming public.

In addition to the general authority for the Federal Reserve to expand the list of activities in which bank holding companies may engage, several of the current legislative proposals specifically authorize holding companies to engage in certain activities. We will discuss each of these in turn.

Bank Securities Affiliates

Three of the bills before the Committee — S. 1609, S. 2134, and S. 2181 — would permit bank holding companies to establish bank securities affiliates. In doing so they would authorize bank affiliates to provide services which are identical in their basic character to services which banks provide today — the underwriting of state and local revenue bonds and the sponsorship and sale of mutual funds. In addition, two of the bills — S. 2134 and S. 2181 — would authorize a bank securities affiliate to underwrite private mortgage-backed securities.

Underwriting Revenue Bonds

When Glass-Steagall was enacted in 1933, state and local governments, with rare exception, issued only general obligation bonds. In enacting a basic prohibition against bank underwriting of securities, Congress specifically excluded from the prohibition such general obligation bonds.

Even by 1937, revenue bonds constituted only about two percent of state and local obligations outstanding. But today, the market has changed. Now approximately 70 percent of the bonds issued are revenue bonds. Thus, the law must be changed if banks are to continue to serve state and local governments in raising needed capital funds.

All the major organizations of state and local governments, such as the National Governors Association, National Association of Counties, National League of Cities, U.S. Conference of Mayors, and Municipal Finance Officers Association have endorsed bank underwriting of revenue bonds. The principal reason for this unanimity is the cost savings which would be realized by state and local governments in future issues of these bonds.

The reasons for the savings are several. First, the added competition would result in lower underwriting fees. Second, bank participation would add liquidity to the secondary market, thus reducing interest costs. And third, bank participation would expose these issues to new investors, which will reduce interest costs by increasing the size of the market.

Underwriting revenue bonds by a securities affiliate does not increase risks to banks or bank depositors since banks today may hold revenue bonds in their investment portfolios. Further, this added underwriting authority would not provide banks any unfair advantage over securities firms or permit banks to monopolize the market. This is clear from the general obligation underwriting experience where banks and securities firms compete side-by-side. Banks only have about 50 percent or less of that market and frequently banks and securities firms participate jointly in underwriting syndicates.

Mutual Fund Sponsorship

The three products and services bills being considered by this Committee would authorize bank securities affiliates to sponsor, operate, advise and sell mutual funds. Bank trust departments today invest nearly $700 billion in employee benefit and trust accounts. Approximately a thousand banks operate collective investment funds to provide their trust and employee benefit accounts greater efficiencies of management and enhanced investment diversification.

With the mutual fund authority contained in the proposed bills, bank securities affiliates would be able to provide the smaller investor the professional knowledge and experience of its trust department, lower securities transaction costs, investment diversification, and a broader range of investments. There is general agreement among many economists and others that equity investment in American business is the best buy in the world today. Yet, the smaller investor is unable to participate in a really efficient and effective manner in this market. The past year saw a tremendous increase in the growth of equity mutual funds, reflecting the desire of investors to share in the prospects for our economy. But without mutual fund authority, individuals are deprived of the choice of having bank affiliates manage their investments.

Mortgage-Backed Securities

We are pleased that both S. 2134 and S. 2181 recognize an expanded role for bank involvement in the broadening of the secondary mortgage markets by authorizing banks to underwrite and deal in private mortgage-backed securities. Congress has previously authorized banks to underwrite and deal in the revenue bond obligations of state and local housing finance agencies as well as to participate in underwriting and dealing in the obligations of the Federal National Mortgage Association (Fannie Mae), the Federal Home Loan Mortgage Corporation (Freddie Mac), and the Government National Mortgage Corporation (Ginnie Mae). Allowing banks to underwrite and deal in private mortgage-backed securities is a logical extension of that authority.

In the 1970's, the thrust of public policy was to encourage the development and growth of secondary markets for securities guaranteed by federal agencies and federally sponsoring enterprises such as Fannie Mae, Freddie Mac and Ginnie Mae. This process has succeeded. Through 1983, these agencies issued guaranteed, pass-through securities that totalled $211 billion--equivalent to one-sixth of all residential mortgage debt outstanding.

In the 1980's and 1990's, the strong prospective demographic demand for housing suggests that the private sector should be given the opportunity to develop markets for fully private mortgage pass-through securities; securities without federal sponsorship, underwritten and issued by banks, other depository institutions, or investment banks against pools of conventional mortgages. Some of this has occurred already. Bank of America, together with Salomon Brothers, in 1977 developed the pioneer issue of private mortgage-backed securities. Subsequently, public offerings of private mortgage-backed securities have exceeded $5 billion.

In the current deregulation environment in which banks and other mortgage originators must operate, there is a need for sophisticated liability management to avoid balance sheet maturity mismatch problems. Mortgage originators must be able to sell the loans that do not fit into their portfolio maturity structure. As the second largest source of residential credit, banks and bank-affiliated mortgage companies need the ability to efficiently tap funds held by life insurance companies, public retirement funds and private pension funds. These institutions traditionally have invested in long-term assets to match their long-term contractual obligations. Through the secondary market, these institutions can obtain their desired mix of assets and the needs of the housing market can be served.

Through S. 1821, the Secondary Mortgage Market Enhancement Act (passed by the Senate as S. 2040), this Committee has already launched an effort to remove this significant regulatory impediment to the issuance of private mortgage-backed securities. However, the authority for national banks to underwrite and deal in private mortgage-backed securities, which was originally contained in S. 1821 and supported by all the witnesses testifying on that bill, was deleted from that bill for consideration in S. 2181.

In light of the pressures facing our mortgage financing systems and the basic issue of competitive equity which both S. 2134 and S. 2181 seek to address, we urge the Committee to act favorably on those provisions removing impediments to the growth and expansion of banks and other depository institutions participation in the private mortgage-backed securities markets.

Real Estate Services - Equity Participation/Brokerage

The American Bankers Association supports the real estate powers included in S. 1609 and S. 2181. Specifically, the provisions in these bills would allow bank holding companies to engage in activities of real estate investment, development, and brokerage, provided that in the case of real estate investment and development, the percentage of a bank holding company's capital that may be devoted to this activity shall not exceed five percent. As stated in the text of S. 2181, real estate investment and development shall include, but not be limited to, the acquisition, management, and maintenance of developed or undeveloped real estate, but shall not include any form of construction activity.

Real estate lending is a major activity of full service banks. Banks are the second largest source of funds for home mortgages, accounting for approximately 23 percent of mortgage originations during the first nine months of 1983. Banks and bank holding companies own a substantial number of mortgage banking firms through which additional millions of dollars of loans are originated and serviced. However, the scope of bank real estate lending is far broader than just single family mortgage lending. Historically, commercial banks have been one of the major sources of construction loans, warehousing loans to mortgage bankers, mobile/manufactured housing loans, home improvement loans and commercial and industrial mortgages. Nevertheless, commercial banks are operating at a competitive disadvantage because unlike some state chartered savings and loan associations, savings and loan service corporations, life insurance companies, and other nonbank competitors, commercial banks are legally disadvantaged in meeting customer needs in the real estate financial markets. Among the limitations on bank activities are the prohibitions from the management, brokerage, syndication and equity investment in real estate.

During 1983, our Association commissioned a study by Arthur Young and Company to assess the feasibility and profitability of bank entry into selected service markets from which they were formerly or are currently prohibited. Included in the selected service markets were real estate equity and real estate brokerage. The results of this study, entitled Assessment of Business Expansion Opportunities for Banking, have already been forwarded to the Committee staff. The study concluded that both real estate equity and brokerage activities would be attractive to all commercial banks regardless of asset size.

Subsequent to the completion of the Arthur Young study, a second major effort was undertaken with Peter Merrill Associates. The public policy aspects of bank participation in real estate equity markets were examined. The Merrill group was asked to determine whether banks should be precluded from making real estate equity investments because of potential conflicts of interest, safety and soundness, or market performance considerations. The study concluded that potential conflicts of interest could be adequately regulated; banks would not incur any more risk than what already exists through real estate lending operations~~; and~~ there is potential for improved market performance by allowing them to do so. The study also concluded that the potential public benefits from improved market performance could not be achieved with the overly restrictive 5 percent of capital limitation contained in S. 2181. Drafts of the final report of this project are now being written, and should be available to the Committee in about three weeks.

For many banks, both large and small, real estate equity investments represent a way to capitalize on existing experience and increase bank profitability through activities that are closely related to current bank activities. Through equity investments, commercial banks and developers have greater flexibility in structuring lending plans in ways that will enhance the financial stability of development projects. The benefits to bank customers and consumers in general are obvious. The greater economic gains resulting from equity participation on the part of commercial banks could reduce the incentive to raise fees and charges for existing consumer services.

The Arthur Young study also contained an analysis of risks involved in certain real estate equity investments. It concluded that those risks are not significantly greater than the ones associated with real estate financing done today by banks. In fact, most of the risks involved are those with which commercial banks have experience through current lending activities. Additionally, S. 1609 and S. 2181 would require all equity investment services be carried out through a subsidiary of a bank holding company, thus insulating the bank and depositors from any risks that might result from these new activities. Many banks, through their mortgage banking affiliates, already conduct the majority of their mortgage lending through a separate subsidiary. Thus, it can reasonably be expected that these mortgage banking affiliates will play an increasingly important role in equity financing and other approved real estate activities.

The Arthur Young study went on to make several additional points. 1) Banks with experience in real estate lending are generally well positioned to enter into real estate joint ventures by taking an equity participation in the projects they finance. 2) Bank real estate departments generally have the expertise required to assess property values and assess the potential for success of a real estate project. 3) Real estate equity positions, especially joint ventures, are closely related to other services offered by commercial banks.

Regarding the exclusion of construction activities within S. 2181, we do not believe that it is equitable to preclude a bank from ownership of a construction firm when builders or real estate firms are free to acquire banks, mortgage bankers, or other depository institutions through the unitary savings and loan provisions or the consumer bank exemption in this proposed bill. At a minimum, the section should be clarified to not preclude or restrict in any way bank participation in development services including project organization, financial feasibility analysis, architect and general contractor selection, construction supervision, sales and leasing administration, project supervision, management and control, nor restrict the ability of banks to continue their current activities in the area of construction and commercial finance. Finally, based on the results of the Peter Merrill Associates study described above, we believe the 5 percent of capital limitation on real estate equity investments is much too restrictive and should be significantly liberalized.

We also believe that the real estate brokerage powers of banks should be enhanced. The real estate broker brings together and represents the parties to a property transaction. Because of commercial banks expertise in the area of mortgage and real estate finance, a natural market for real estate brokerage service exists for them. The Arthur Young study included these relevant points regarding real estate brokerage. 1) Commercial banks have both the resources and capabilities that would enable them to successfully enter into real estate brokerage. 2) Experience and skills acquired through current activities such as real estate appraisals and real estate lending provide commercial banks with the expertise in the real estate brokerage area. 3) Real estate brokerage services are closely related to services currently offered by commercial banks and would allow banks to better serve their customers.

There is also the matter of competitive equity. The parent companies of most major real estate brokerage networks are entering the mortgage banking business in direct competition with banks and other traditional depository institutions. Coldwell Banker is the real estate subsidiary of Sears, Roebuck and Co. and operates with offices in 38 states. It has had a mortgage banking operation since 1967. Recently, Sears Chairman Edward Telling announced plans for the company to distribute its own conventional, mortgage-backed securities to the public.

Merrill Lynch Realty, Inc. is the real estate and mortgage subsidiary of the brokerage firm Merrill Lynch and Co. There are 350 Merrill Lynch Realty Associates in 35 markets around the country. Merrill Lynch Realty has consolidated its mortgage banking activities into Merrill Lynch Mortgage Corp. and Merrill Lynch Mortgage in turn markets mortgage-backed securities to investors through related Merrill Lynch companies.

Commercial Credit Company owns Electronic Realty Associates Inc. (ERA) and Commercial Credit Mortgage Co. ERA offers its residential real estate customers access to first mortgages through Commercial Credit Mortgage. There are about 3000 ERA offices nationwide. Commercial Credit Company has offered second mortgages through its own offices for years, and these offices are now being redesigned as financial services centers that offer both first and second mortgages as well as insurance.

The Meredith Corporation, which is the parent firm for Better Homes and Gardens Real Estate Service, has announced that it will operate a mortgage banking company, Meredith Mortgage Corporation. Realty World Corporation, another major franchisor, is developing a financial services system with its parent company, Thomson McKinnon Securities, Inc. The system includes mortgage and insurance origination and a corporate relocation program.

In short, a number of real estate brokerage networks are becoming involved in mortgage banking and are entering the insurance and securities business. The justification for these activities is to provide customer services by generating home loan money on a continuous basis. But there is no doubt that these mortgage banking operations will be in direct competition with local lenders. We believe that the demand for mortgage financing and real estate services over the foreseeable future is so great that the consumer will benefit by providing the authority for banks to enter the brokerage business on the same terms that the brokerage companies are allowed in banking.

In summary, commercial bank entry into these and other markets currently not permitted will result in significant benefits not only to bank customers but to consumers in general.

Insurance

Our Association strongly supports the provisions in S. 1609 and S. 2181 that would allow bank holding companies to become more involved in insurance brokerage and underwriting activities. However, the specific "safeguards" included in S. 2181 present some serious concerns to bankers. These "safeguards" are designed to reduce the opportunities for tie-ins. However, the lack of any evidence of significant tie-in sales shows that these "safeguards" are unnecessary. They will serve only to increase the cost of providing these services, especially at smaller banks.

Under federal law, national banks are permitted to offer insurance services in towns with 5,000 or fewer residents. State-chartered banks have the authority to provide more extensive insurance services than national banks in a number of states. In some areas (e.g., the unit banking states of the midwest), the combination of banking and insurance activities has been commonplace for decades. In fact, a sizeable portion of the members of the Independent Insurance Agents of America's affiliated state organizations in the midwest are bank agents.

Insurance Brokerage

Both S. 1609 and S. 2181 would allow bank holding companies to sell or underwrite insurance. We feel that the financial nature of insurance activities makes underwriting and brokerage compatible with banking. Brokerage would be more attractive to smaller institutions. Risks associated with insurance brokerage are low. Moreover, barriers to entry into this industry are low, as is the capital requirement associated with operating an insurance agency or brokerage. Banks are well positioned to enter the industry because most lines of insurance are needed by bank customers and are compatible with credit offerings made by banks. The Arthur Young study cited above notes that banks' retail branch networks are admirably situated to offer insurance more efficiently and on lower margins than many independent insurance agents. In short, of virtually all the activities discussed, insurance brokerage appears to be one of the most compatible with the banking industry and one in which no significant risks would be raised for the deposit insurance fund.

Insurance Underwriting

Historically, banking and insurance underwriting have been very closely related. Indeed, in essence the two are one business, because both involve the solicitation of deposits (premiums) from customers and the investment of those deposits in loans or securities until the need arises to return them to the customer. In fact, to a large extent, life insurance is a less risky business than banking because the existence of advanced actuarial tables can dictate far more reliably the time at which income must be paid out than existing demand deposit and other bank deposit contracts.

Safeguards

The "safeguards" that are included in the language of S. 2181 impose a much higher standard on bank holding companies offering these services than are present in the marketplace. The insurance industry is not held to the same standards that are being suggested for bank holding companies even though many members of the insurance industry are involved in businesses other than insurance. The proposed limitations included in S. 2181 imply that banks offering certain insurance services have market power in providing banking services that they would exploit in offering the insurance. Despite unsupported insurance industry assertions to the contrary, there has never been any evidence presented by that industry that tie-ins, either explicit or implicit, are a common practice.

The opportunities for coercive lending practices are limited because the number of credit extensions that lead to insurance sales ("penetration rate") is low, many bank customers get insurance through established relationships or from shopping around, and insurance services are usually offered after an extension of credit has been approved.

Tie-ins also are unlawful under both the antitrust laws and Section 106 of the 1970 Amendments to the Bank Holding Company Act.

> A bank shall not in any manner extend credit, lease or sell property of any kind, or furnish any service, or fix or vary the consideration of any of the foregoing, on the condition or requirement-
>
> 1) that the customer shall obtain additional credit, property, or service from such bank other than a loan, discount, deposit or trust service;
>
> 2) that the customer shall obtain additional credit, property, or service from a bank holding company of such bank, or from any subsidiary of such bank holding company.

The provisions, by their terms, are applicable to all extensions of credit, leases or sales of property of any kind, the furnishing of any service, and the pricing of any of the foregoing. The anti-tying provisions are unusual in banking law in that they both provide the opportunity for enforcement by the federal bank regulatory agencies, and also provide a specific private right of action to plaintiffs who may have been injured as a result of tie-in sales. Moreover, Section 106(e) of the existing anti-tying provisions authorizes recovery by plaintiffs of treble damages for any violation, as well as the cost of suit and reasonable attorney's fees. This extraordinary remedy is obviously designed both to deter violations on the part of individual banks, and to encourage plaintiffs who may have been harmed by such violations to bring suit for the recovery of damages.

Nevertheless, it is instructive to note that these anti-tying provisions, although they have been in effect for thirteen years, have been rarely used by plaintiffs. We believe that the very paucity of their use indicates the fact that they have been successful in deterring bank tie-in sales. In addition, the breadth of the prohibition of tie-ins in the statute ensures that whatever new activity banks may engage in will be subject to these prohibitions. It is also a specific responsibility of bank examiners to report any evidence of coercion.

Most of the services provided by banks are also provided by other types of financial institutions. For this reason, any attempt to coerce a customer would result in a customer moving to a competitor. Moreover, it makes no sense to jeopardize a customer relationship by using coercive practices to increase just one part of that relationship.

Furthermore, because the insurance industry is also a significant factor in the markets for financial services (e.g., in commercial lending, real estate lending and as a holder of corporate bonds), there is the potential for conflicts of interest in that industry as well. Additional competition will lessen the potential for abuse by existing providers of financial services.

The insurance industry has been highly critical of banking's supposed attempt to "circumvent" Title VI of the Garn-St Germain Act of 1982 at the state level. At the same time, the insurance industry is supporting a federal legislative moratorium that would temporarily stop the integration of banking with insurance and other nonbanking activities despite the fact that the McCarran-Ferguson Act of 1945 left to the individual states the authority to regulate insurance and exempted the industry from antitrust statutes. We believe the principle of functional regulation contained in S. 1609 and S. 2181 would minimize any regulatory conflicts associated with the expansion of banking's insurance activities.

It has been suggested by insurance industry representatives that the insurance services offered by banks and bank holding companies are somehow inferior to the services provided by unaffiliated agents. Agents affiliated with banks or bank holding companies represent the same underwriting companies and offer the same products and services as unaffiliated agents. Moreover, no banker would ever jeopardize a valuable banking relationship by poor insurance service.

In several northeastern states, state chartered savings banks are already allowed to sell life insurance. A 1980 Consumers Union Report on Life Insurance states: "Savings bank life insurance, offered by mutual savings banks in Massachusetts, New York, and Connecticut, is quite an economical purchase, in part because the savings banks offer the insurance on a walk-in basis with no overhead for a full marketing apparatus in support of a field force of agents." In its own self interest, a progressive banking organization will give as good or better services as any insurance agency in the area, or it will get out of the insurance business.

Our Association would therefore strongly urge the expansion of permissible activities for bank holding companies to include insurance underwriting and brokerage. However, S. 2181 contains unnecessary, impractical, anti-competitive constraints. Without adding any significant safeguards, these restrictions complicate insurance sales procedures with needless duplication and paperwork and jeopardize the chances of bank holding companies successfully engaging in these activities.

Thrifts

Both S. 1609 and S. 2181 would allow bank holding companies to acquire insured savings and loan associations. Under S. 2181, when a bank holding company acquires a savings and loan, that acquisition would be subject to the Douglas Amendment and future branching would be restricted by the McFadden Act. Conversely, when a savings and loan holding company acquires a bank, the Douglas Amendment would apply.

The American Bankers Association strongly supports the provision allowing bank holding companies to acquire thrifts. We also support the provision of S. 2181 which states that an acquisition by a bank holding company of an insured savings and loan shall be subject to the same restrictions as if the insured institution were a bank. There should not be an advantage in acquiring a thrift over a bank. Both acquired institutions should be subject to the Douglas Amendment restrictions.

We view the issue of multi-state affiliations between commercial banks and thrift institutions as a part of the broader question of possible changes in geographic limitations. Our Association does not believe it is necessary to examine these issues in the context of legislation providing substantive new powers for bank holding companies.

Generally, the Federal Reserve Board has not allowed bank holding companies to acquire thrifts. The Board has indicated that they are "closely related to banking" but are not a "proper incident thereto." However, the Board has allowed the acquisition of financially troubled savings and loans.

The legislative history accompanying the 1970 Amendments to the Bank Holding Company Act clearly reflects and supports the conclusion that it was the intent of Congress to permit such affiliations if the statutory criteria of

Section 4(c)(8) of the Act were met, and if the approval of the Federal Reserve Board were obtained. With the expansion of thrift institution authority into bank-related services, it would be difficult to determine that the savings and loan business is not "closely related" to commercial banking activities. Aside from the obvious similarities in most deposit-taking areas, both commercial banks and savings and loan associations can provide essentially identical loans to virtually any consumer.

Our Association also believes that the affiliation of nonbank depository institutions with bank holding companies is a proper incident to banking and will increase competition and provide savings and loan associations with better access to needed capital. In addition, significant operating efficiencies could be achieved by permitting bank holding companies to operate nonbank depository institutions. The technical efficiencies of bank holding companies, which result from the utilization of well-designed operating systems and facilities, should improve the professional and productive capabilities of nonbank depository institutions.

This concludes our discussion of specific products and services that would be authorized by the current legislative proposals. Next I would like to discuss the limitations which some of these proposals would impose on banks offering additional products and services.

Additional Glass-Steagall Restrictions

S. 2134 would extend to state nonmember banks and their subsidiaries, Glass-Steagall restrictions regarding securities affiliates, personnel interlocks and mixing certain securities activities with deposit taking in the same entity. Congress did not include state nonmember banks in the Glass-Steagall restrictions because in 1933 it felt it lacked the power to regulate state banks unless they had joined the Federal Reserve. Because of this gap in the law, a number of securities firms in recent years have acquired banks. For example, Shearson/American Express acquired Boston Safe Deposit and Trust Company, Fidelity acquired Fidelity Trust Company, Dreyfus acquired both a national bank and a state bank, and Prudential-Bache acquired a bank. In each instance the acquired banks do not make enough commercial loans to be a bank for bank holding company purposes, because this would add the further complication of Federal Reserve approval and the interrelationship of the Bank Holding Company Act and Glass-Steagall Act, if any. In addition, two mutual savings banks have entered into securities activities that are probably impermissible for national or state member banks under Glass-Steagall. No commercial state nonmember bank has yet sought to engage in restricted securities activities through a subsidiary or other affiliate, even though the FDIC has made it clear that it agrees that they could and has proposed rules to limit the extent of such activity for safety and soundness reasons. It would be extremely unfair to adopt the language in S. 2134 that would prevent state banks from acquiring securities subsidiaries.

Concentration of Resources

Under Title I of S. 2181, a bank or savings and loan holding company with aggregate domestic deposits exceeding 0.3 percent of total domestic deposits would be prohibited from acquiring a large insurance, securities, real estate or other financial organization engaged in an activity authorized under Section 4(c)(8) of the Bank Holding Company Act if the investment in any one of the activities exceeds 25 percent of its capital. A similar standard would be applied to large financial organization acquisitions of large banks or thrift institutions. These proposed standards are designed to limit the acquisitions of approximately 25 of the largest holding companies.

As applied to the banking industry, the existing antitrust laws provide a powerful disencentive to the development of any significant economic power within the industry. We believe they are sufficient to prevent any undue concentration of power.

A 1978 Federal Reserve Board Staff study (The Bank Holding Company Movement to 1978: A Compendium) concluded that bank holding companies have not significantly increased their control over aggregate financial resources in the economy as a whole —nonbanking resources accounted for less than 4 percent of bank holding company resources. In addition, the study concluded that bank holding companies have not significantly increased concentration in commercial banking at the national, state, or local levels.

The expansion of bank holding companies into the permitted, closely-related activities has been accomplished substantially through the formation of new subsidiaries rather than by acquisition. The difference between the formation of new subsidiaries and expansion by acquisition was recognized by the Congress in 1970, and was clearly embodied in Section 4(c)(8) of the Bank Holding Company Act. Consequently, the formation of new subsidiaries requires a much simpler and less formal procedure unless it appears appropriate to apply more formal procedures. In its recent revision of Regulation Y, the Federal Reserve Board concluded that de novo expansion is procompetitive and there is no evidence of any significant adverse effects associated with de novo expansion. As a result, the Board eliminated prior approval for de novo expansion of previously approved nonbanking activities in the United States.

A 1981 Federal Reserve Board staff study (Multibank Holding Companies: Recent Evidence on Competition and Performance in Banking Markets) also found a deconcentrating effect from de novo entry by bank holding companies. In fact, the study concluded that the evidence suggests that de novo banks established by holding companies may be more successful than new, independent banks in breaking down high market concentration.

Additionally, most of the acquisitions of banks by holding companies since 1970 have been of the "market extension" variety. That is, the bank being acquired has been in a different market area than the existing subsidiaries of the holding company. "Market extension" acquisitions tend to increase the apparent degree of concentration of banking resources in a state, but they do not increase concentration in local market areas. In interpreting the antitrust laws, the courts have held that it is the degree of concentration in local market areas that is relevant to the measurement of the competitive effect of a bank merger or acquisition. Mergers or acquisitions that significantly increase concentration in local market areas have been effectively prohibited in banking since 1963. It is not surprising, therefore, that holding company growth has not tended to increase concentration in relevant market areas and that the trend in such areas has been toward less concentration.

The previously mentioned article in the February 1982 Federal Reserve Bulletin found some decline in the concentration of commercial banking on the national level in terms of the proportion of domestic deposits held by the 10 largest and 100 largest banking organizations from year-end 1969 to year-end 1980. While there was some increase in concentration on the statewide level in the statewide branching states from 1970 to 1980, average concentration ratios for Standard Metropolitan Statistical Areas declined over the period in all branching categories.

Moreover, data show that banking is not a particularly concentrated industry relative to other financial or nonfinancial industry groups. These data indicate that the competitive structure of banking and, indeed, much of the financial services industry is very healthy compared to the rest of the economy. Some sectors of the financial services industry such as finance companies, insurance, and securities brokers and dealers are more concentrated than banking. In any case, it would take a lot of consolidation before the financial services industry reached the level of concentration indicated for some nonfinancial groups. But these data only tell half the story.

Changes in laws and regulations, most notably the Depository Institutions Deregulation Act of 1980 and the Garn-St Germain Depository Institutions Act of 1982 have made depository institutions look more and more alike in terms of the services they are allowed to offer the public. These changes were prompted by changing economic conditions in the marketplace which undoubtedly will continue for the foreseeable future. Depending on market conditions, some institutions will continue to specialize, and others will offer more diversified financial service packages. However this eventually sorts out, it is clear that the net result will be a decrease in concentration in the depository institutions section of the financial services industry. We see no reason why this same trend should not occur if the restrictions subdividing depository institutions from the rest of the financial services industry were also liberalized.

It should also be noted that conglomerate mergers do not increase concentration in particular lines of business. A merger between a securities firm and an insurance company does not change concentration in the insurance business or the securities business. It may create a stronger organization to operate in both of those lines of businesses. It may be true that, as the financial services industry evolves, the various segments of the industry will tend to look more and more alike. But even if this prediction is correct, this end result gives us no clue as to concentration in such an evolved industry or whether or not a proposed cross-industry merger would increase or decrease concentration in such an evolved industry. If such a melding of institutions is taking place, it is in response to changes in marketplace demands. Restrictions on such mergers would only hamper institutions in satisfying those demands.

We believe experience in the banking industry indicates that the existence of large institutions in a particular market does not threaten the existence of well-managed smaller institutions. We believe it is also true in other segments of the financial services industry. Despite the long dominance of Wall Street firms in the securities business, smaller regional firms continue to grow and prosper. Another example of smaller, specialized institutions that continue to grow and prosper are the approximately 20,000 credit unions.

Furthermore, Title I of S. 2181 would require the Federal Reserve Board to "promote competition between bank holding companies and all other companies engaged in activities of a financial nature or closely related to banking." We believe this provision would further ensure that competition would be increased and concentration would be decreased.

In summary, we believe the antitrust laws are sufficient to protect the financial services industry from undue concentration of economic power. Banking is among the least concentrated industries in this country under existing law, and almost no rational scenario can be developed which envisions the type of growth and concentration in the industry that would significantly lessen its competitive nature. We, therefore, believe that existing antitrust laws and the provision in S. 2181 that would require the Federal Reserve Board to promote competition are more than adequate to protect against concentration in our economy. For this reason, we do not believe that the proposed concentration standards in Title I of S. 2181 are necessary.

State Preemption

S. 2181 would prohibit states from limiting the effectiveness of its provisions by prohibiting national banks within their jurisdiction from affiliating with holding companies engaged in the new activities provided by the bill. It would also forbid a state to authorize state-chartered banks to engage in insurance activities outside its boundaries if they could not engage in such activities within its borders.

Our Association's longstanding support for the dual banking system in this country is well known to this Committee. We would nevertheless support the provisions of this bill forbidding states from prohibiting national bank affiliations with holding companies engaged in the new activities authorized by the bill. The securities and insurance industries to which major provisions of this bill are directed have long been recognized as national activities. Real estate brokerge and investment have been traditionally more localized activities; but with the development of such nationwide real estate companies as Sears-Coldwell Banker, real estate, too, is becoming nationwide in scope. Without the limitations provided by Section 104(h) of S. 2181, states would be able to limit the ability of national banks to engage in these national activities, and those bank holding companies wishing to engage in securities, insurance, and real estate activities as provided under this legislation would be forced to confront a checkerboard of state laws of a type that would not affect their primary nonbanking competitors.

We do not believe that the provisions of subsection (h) restrict in any fashion the present ability of states to regulate the real estate, insurance, and securities activities of all entitities engaged in those activities within their borders. The only effect of this subsection, we believe, would be to prevent discriminatory laws singling out national banks or bank holding companies for unique treatment under state law when they wish to engage in these new activities. We believe this provision should be expanded to preclude discrimination against state members banks, if not all banks.

The second provision of subsection (h) would limit the ability of a state to authorize insurance activities for its state-chartered institutions by requiring that those insurance activities could only be provided on the same basis outside the state as within the state. Although we are concerned that this provision could be seen as a precedent for federal limitations on new state authorizations for banking activities, we would nevertheless not oppose this narrow requirement of nondiscriminatory treatment in insurance activities.

2. Formation of a Bank Holding Company

The new products and services discussed in the previous section would be offered through nonbank subsidiaries of a bank holding company. Thus, it is important to remove unnecessary impediments to the formation of bank holding companies to insure that banking organizations of all sizes will be able to take advantage of these new opportunities to serve their customers. Under current law, a bank must file an application with the Federal Reserve to establish a holding company even though the shareholders of the holding company are basically the same as the bank's shareholders. After receiving Federal Reserve approval, the bank must wait 30 days for the Justice Department to consider any antitrust implications. Further, if there are any shareholders that reside in another state and the number of shareholders exceed the number that may qualify as a private placement, the holding company must register with the Securities and Exchange Commission under the 1933 Securities Act. These procedures are costly and time consuming.

All three deregulation bills — S. 1609, S. 2134, and S. 2181 -- would make the same changes in current law. Where shareholders are merely going to exchange their bank stock for stock of a holding company so that each holds substantially the same proportional share interest in the holding company, the bills provide for a 30 day pre-notice procedure with the Federal Reserve that places the burden on the Federal Reserve to justify stopping the holding company formation. All three bills also eliminate the 30 day wait for Justice to consider nonexistent antitrust implications, and exempt such transactions from the 1933 Securities Act registration provisions.

These actions make a great deal of sense. The banking unit is not escaping from any regulation in becoming part of a holding company. In fact, as under current law it may be picking up a new regulator, the Federal Reserve. The Federal Reserve is authorized under all three bills to establish by regulation capital and other financial standards that must be met by the new holding company. The elimination of the 30 day period for Justice to react has no adverse consequences because the new economic unit is the same as the old except for its restructuring.

As for investor protection, again, the shareholder is receiving an even economic exchange. What was owned by the investor by virtue of the bank stock is still owned by the investor by virtue of the holding company stock. The ABA urges the adoption of these changes in the Bank Holding Company Act and the 1933 Securities Act.

3. Procedure to Engage in Nonbanking Activities

All three proposals -- S. 1609, S. 2134 and S. 2181 would provide a substantially modified procedure for bank holding companies wishing to engage in nonbanking activities. Under present law, the Board of Governors has 91 days from the acceptance of a completed application to act on that application. In spite of that 91-day limitation, it is not uncommon for bank holding company applications before the Board of Governors to consume a year or more in the application process. These delays in considering applications have arisen because of an extended review period at the Board's staff level before an application is accepted for processing by the Board of Governors.

The review procedures of all three proposals are a substantial improvement on the present procedure. Under all three bills, an applicant could not engage in any nonbanking activity either de novo or by acquisition unless it first submitted a notice to the Federal Reserve Board of its intent to do so. The Federal Reserve Board would then have sixty days either to disapprove the new activity or to extend for an additional 30 days its opportunity for disapproval. This new procedure would speed the application process both by eliminating the sometimes lengthy preapplication review, and also by deleting the opportunity provided under present law for every potential opponent of an individual applicant to demand a Board hearing on an application and to sue the Board after an application is approved. Therefore, our Association believes this language to be a significant improvement on existing law.

The three bills also attempt to limit somewhat the types of information that the Board may request during the application process for approval of a nonbanking activity. In general, they would limit the Board to requesting information relating to the managerial resources of the companies involved, the adequacy of their financial resources, information regarding practices that may impair the credit judgment of a bank affiliated with the bank holding company applicant, or any material adverse effect the application might have on the safety and soundness or financial condition of an affiliated bank or banks.

We believe that these limitations are not substantial improvements over existing law with regard to the type of information that the Board may request of applicants for nonbanking activities. The major purpose of these proposals is to provide bank holding companies with the flexibility to engage in activities on the same terms and conditions to which their competitors are subject. This entire application process for nonbanking activities appears designed not to protect the safety and soundness of banks affiliated with bank holding companies, but rather to broaden the scope of jurisdiction of the Federal Reserve Board of Governors to allow them to intrude more directly into the affairs of the new activities in which bank holding companies may engage. No nonbanking competitor of a bank holding company will be subject to such intrusion. Nor has any evidence been brought forward to indicate why such close supervision is necessary when the very structure of a bank holding company will provide insulation for its subsidiary banks from any nonbanking activities.

Our Association strongly believes that any information submitted during an application process should be limited solely to a review of the safety and soundness of bank subsidiaries of a bank holding company and any impact that a new nonbanking activity might have on that safety and soundness. For that purpose, the information to be submitted should be limited to an examination of the affairs of subsidiary banks and of the holding company itself and not of any other activities of the holding company. The Board of Governors has in the past shown a willingness to turn an application process into an opportunity for a full-scale review of the management and other practices of all institutions affiliated with the applicant. Such a full-scale review has been used to accomplish regulatory purposes unrelated to the application under review, and has never been demonstrated to be of significance to the safety and soundness of subsidiary banks. We would therefore urge that the provisions of all three bills authorizing Board review of notices to engage in nonbanking activities be limited solely to an examination of any effect that those activities may demonstrably have on the safety and soundness of bank subsidiaries of the holding company.

4. Nonbank Activity Supervision

All three proposals — S. 1609, S. 2134, and S. 2181 — would amend Section 5(c) of the Bank Holding Company Act to create a limited bias in favor of a lowered regulatory burden on the nonbanking subsidiaries of bank holding companies. Our Association would prefer that the Board of Governor's supervision of the nonbanking activities of bank holding companies be limited to such activities as may have a significantly adverse effect on the safety and soundness of any bank subsidiaries of the bank holding company. We believe that the language of all three bills begins to move in the right direction toward accomplishing this result.

That language would require the Board to accept reports submitted to the Securities and Exchange Commission as meeting its reporting requirements in most circumstances, and would direct the Board to limit, insofar as possible, its examination of nonbanking subsidiaries of bank holding companies to those activities which might have a material adverse affect on the banking activities of the holding company. While these admonitory provisions of the bill would have the salutory effect of limiting Board involvement in nonbanking subsidiaries, we believe it important to point out that bank holding companies' competitors engaged in similar activities would not be subject to any similar reporting or examination requirements by the Board. Thus, contrary to the deregulatory intent of all three bills, bank holding company nonbanking subsidiaries will continue to be subject to a dual level of regulation not affecting other institutions in the same lines of business.

5. Definition of Bank

Today, the Bank Holding Company Act (BHCA) contains a specific definition of a bank. This definition is important because it determines the activities that can be engaged in by the parent of the bank, in other words, who can own a bank. It also determines whether the parent is regulated by the Federal Reserve.

The present definition of "bank" for purposes of the Bank Holding Company Act is inadequate for today's marketplace. Many companies have utilized exceptions in the present law to acquire so-called nonbank banks that are not subject to bank holding company regulations. We support the legislative efforts to redefine a "bank" to close up existing statutory loopholes that permit the existence of nonbank banks.

Under existing law a bank is not a bank under the BHCA unless it both takes demand deposits and makes commercial loans. A bank can make consumer loans, mortgage loans or any other kind of loan other than commercial and its parent will not be subject to the activity limitation of the BHCA and it will not be regulated by the Federal Reserve. Because of this definition, many companies engaged in a wide variety of activities have been able to acquire or apply for charters of state or national banks. These companies range from Gulf and Western and J.C. Penney to Dimensions Financial Corporation, Inc. Because the BHCA does not apply, the interstate restrictions of the Douglas Amendment are inapplicable. Dimensions has filed for 31 National bank charters in 25 states.

All three pending bills -- S. 1609, S. 2134, and S. 2181 -- redefine bank for purposes of the Bank Holding Company Act. Of these definitions, ABA finds the definition of bank contained in S. 1609 to be the most comprehensive.

However, we would modify it by including the trust exclusion contained in S. 2134.

We urge the Congress to decide that a bank is a bank and subject all banks to the same rules as is done by S. 1609. Consequently, we strongly oppose the "consumer bank" exclusion found in S. 2181. Our problem, today, is that everyone else in the financial services industry can acquire and own a bank, but banks are unable to offer these other financial services. All participants in the financial services industry should be treated with more evenhandedness.

Both S. 1609 and S. 2134 are very close in their redefinition. Under both, a "bank" is described as an "insured bank", an institution that is eligible to become an "insured bank" or an institution that has transaction accounts and makes commercial loans. All of these proposals specifically exclude (1) a foreign bank having an insured branch, (2) a federally insured thrift, (3) an Edge Act Corporation or (4) any organization whose U.S. business is only incidental to its business outside the United States. The Proxmire bill, S. 2134, includes one more exclusion from the definition of a bank, an institution that functions solely as a trust company and substantially all of its deposits are received in a fiduciary capacity. We recommend that this feature of S. 2134 be included in the final definition of "bank" in the legislation acted on by this Committee.

The definition of a bank in S. 2181 is substantially different. After a great deal of complex statutory language, it ends up with an effect substantially the same as today's law, except it would allow banks doing considerable commercial lending to be acquired or owned by anyone. It would, however, limit interstate acquisitions of some banks that escape the definition.

S. 2181 begins by defining a "bank" for BHCA purposes as an "insured bank" or an institution that has transaction accounts and makes commercial loans. It does not include uninsured institutions eligible for FDIC insurance. It excludes the same institutions as S. 1609, but then it goes beyond S. 1609 and specifically excludes a "consumer bank" and any Morris Plan bank, industrial loan company, or similar institution that does not both accept demand deposits and make commercial loans. Next, the bill defines "consumer bank" as any bank that does not make commercial loans. Then it wraps up the whole concept of "bank" by specifying types of loans that are not commercial loans. Thus, an insured bank may make any of the following type loans without becoming a "bank" for BHCA purposes.:

1. loans for personal, family or household purposes
2. loans for charitable purposes
3. loans secured by residential real property
4. loans to individuals through credit cards or similar access methods
5. money market instrument investments
6. broker call loans
7. mortgage-backed securities
8. U.S. obligations, state and local government obligations including industrial development bonds
9. consumer goods inventory loans, small business loans and similar loans so long as in the aggregate they equal less than 5 percent of assets

The definition of a bank in S. 2181, with the consumer bank exclusion and the failure to include institutions eligible for FDIC insurance, opens the door even wider to banking and access to the payments system by those in other businesses. It does, however, draw the line for consumer banks at only one state per holding company unless it is invited into another state either specifically to acquire a "consumer bank" or to acquire a "bank" or an industrial bank. If Congress were to adopt the approach of S. 2181 and exclude "consumer banks" from the definition of "bank", the Douglas Amendment concept of S. 2181 should apply to consumer banks and banks eligible for FDIC insurance because interstate banking is clearly a separate issue and should not be backed into through this legislation.

All three bills — S. 1609, S. 2134, and S. 2181 — grandfather "banks" acquired before July 1, 1983 or June 23, 1983, so long as the parent holding company does not undertake any new activity other than those authorized for bank holding companies.

Our Association feels strongly that for purposes of the Bank Holding Company Act, a bank should be strictly defined as: 1) an FDIC insured institution; 2) any institution eligible to be FDIC insured; 3) any institution that accepts deposits that a depositor may withdraw by check or similar means for payment to third parties and is engaged in the business of making commercial loans. We believe that the definition of S. 1609 with the modifications we have suggested comes closest to meeting these criteria.

6. Thrift Regulation

Multiple Savings and Loan Holding Companies

ABA believes that any financial institution that uses the name bank should be subject to the legislative and regulatory rules governing banks as defined by the Bank Holding Comapny Act. We believe that thrift institutions which choose to operate in the marketplace as full service financial institutions, rather than specialized mortgage lenders, should utimately become subject to the definition in the Bank Holding Company Act. In the context of the legislation pending before this Committee, we recognize a general Congressional desire to subject thrift institutions to regulatory controls under the Savings and Loan Holding Company Act parallel the regulatory provisions imposed on banks by the Bank Holding Company Act. The provisions of S. 1609 and S. 2181 provide parity between what is permissable for a bank holding company and what is permissable for a multiple savings and loan holding company. We support the provisions of S. 1609 and S. 2181 that would allow a bank holding company, subject to the new procedures in Section 4(c)(8) of the Bank Holding Company Act, to engage in any activity permissible for a multiple savings and loan holding company on July 1, 1983, subject to such limits as the Federal Reserve Board may prescribe. This would be a step in the right direction toward achieving parity in holding company regulation.

With respect to the concept of a "qualified thrift lender," the Garn bill — S. 2181 — provides that a unitary savings and loan holding company whose savings and loan subsidiary qualifies as a "qualified thrift lender" would be subject to no restrictions on its non-savings and loan activities. The legislation defines a "qualified thrift lender" as a savings institution that has either not more than 25 percent of its assets in commercial-type loans or not less than 60 percent of its assets in various types of residential real estate loans and investments. All other savings and loan holding companies would be required to limit their non-savings and loan activities to the following: (1) the same activities permissible for bank holding companies under the Garn bill; (2) activities permitted under current law for multiple savings and loan holding companies; and (3) grandfathered activities. These restrictions would not apply to a unitary savings and loan holding company which acquired a thrift under the emergency thrift acquisition procedures of the Garn-St Germain Act. For these savings and loan holding companies, S. 2181 establishes procedures and restrictions under the FSLIC which parallel those applicable to bank holding companies.

The Treasury proposal - S. 1609 - contains the same provisions except that all savings and loan holding companies, other than a unitary savings and loan under the emergency procedures, would be subject to the activities limitations. In other words, there would be no exception for qualified unitary holding companies. Our Association supports the provisions in S. 1609 as opposed to the provisions in S. 2181 because any restrictions should apply evenly across industry lines. Under S. 2181, a unitary savings and loan holding company that is a parent to a qualified savings and loan would be free to engage in any non-savings and loan activities without restrictions. This gives such holding companies an unfair advantage and disregards any need for built-in safeguards for holding companies engaging in such businesses.

The Treasury proposal, S. 1609, on the other hand, would subject all firms performing the same functions to the same regulations. We support the principle of functional regulation and believe it will provide a level playing field for all institutions providing the same types of financial services. This principle will ensure that those institutions that fare well in the marketplace do so because they most efficiently meet the needs of their customers, not because of advantages granted by a regulatory body.

7. Payment of Interest on Reserves

Title IV of S. 2181 would direct the Federal Reserve to pay interest on reserves held against Money Market Deposit Accounts, Super NOW Accounts, and any similar accounts authorized in the future. Interest would be paid at the average rate earned by the Federal Reserve on its portfolio of securities.

The proposal for payment of interest on reserves included in Title lV of S. 2181 does not provide a satisfactory solution to the reserve requirement problem. By limiting payment of interest to reserves held against Money Market Deposit Accounts and Super NOW Accounts, it insures that most commercial banks would receive interest on only a small portion of their reserves.

The requirement that depository institutions hold their reserves in noninterest bearing form imposes an implicit tax on those institutions. This tax reduces the interest rate which depository institutions can afford to pay on deposits, making it difficult for them to compete with other institutions that offer deposit like instruments not subject to reserves.

The tax also creates incentives to devise new financial instruments that are close substitutes for demand deposits but are not subject to reserve requirements. In recent years, development of these new financial instruments has clouded interpretation of the money supply figures and complicated the execution of monetary policy. Paying interest on reserves will increase the effectiveness of monetary policy. It would also help create an environment in which payment of interest on demand deposits can be considered, a subject we will take up next. However, elimination of the implicit tax on deposits requires that interest be paid on all reserves held at the Federal Reserve. Even then, interest payments on reserves held at the Fed would offset only a small portion of the cost of paying interest on demand deposits, especially at smaller banks which in many cases hold the bulk of their required reserves in the form of vault cash.

8. Usury Preemption

Our Association has a longstanding position supporting the removal of artificial constraints on the ability of the competitive marketplace to determine the price of credit. We strongly support the provisions of S. 2181 regarding the preemption of state usury ceilings.

A brief historical review will put our position in perspective. The 1980 Depository Institutions Deregulation and Monetary Control Act began the federal deregulation of both the asset and liability side of banking's balance sheet. The Act contained a total override of all state restrictions on interest rates and discount points or finance charges that affected first mortgages on real estate and manufactured housing. It also provided a three year override of state usury ceilings on business and agriculture loans coupled with a floating federal ceiling, and extended to state chartered, federally insured, banks the minimum rate formerly enjoyed only by national banks, of one percent over the discount rate.

On the liability side, the Act provided for a six year phaseout of federal restrictions on the amount of interest depository institutions could pay on their deposits. This phaseout has now been nearly completed by the Garn-St Germain Depository Institutions Deregulation Act of 1982 and subsequent actions by the Depository Institutions Deregulation Committee. These actions affecting the liability side of the bank's balance sheet have had the effect of converting a large number of formerly noninterest bearing deposits or low rate deposits into deposits bearing competitive rates. We agreed with and supported this deregulation. However, this deregulation should be accompanied by further deregulation of the asset (loan) side of the bank ledger.

Banks operate on "spread", the difference between what they pay out on deposits and what they take in on loans. The 1980 and 1982 Acts have made major changes in the cost of banking's liability portfolio. The new money market accounts have made the rate paid on deposits market sensitive. In order to avoid undue losses during periods of rising interest rates, loan rates also should be allowed to respond to market pressures. This cannot be achieved unless restrictive usury ceilings are completely eliminated.

The time has come for the Congress to deregulate lending activities with respect to rates. Such action should be true deregulation, not simply re-regulation.

The primary rationale for establishing and maintaining usury ceilings has been to prevent lenders from charging exorbitant rates for credit. Traditionally, usury ceilings have been aimed at the consumer lender because consumers have been felt to be less well informed than business or commercial borrowers. This argument has always ignored the most important aspect of the system which will prevent such a result - competition among lenders - and its current use ignores the cadre of consumer legislation enacted over the past decade which insures that the consumer is adequately informed and equitably treated.

As shown in the following examples, market forces do serve to properly determine the price and availability of credit. Many states have totally eliminated usury ceilings. Not one state that has eliminated ceilings has reimposed them. In fact, a referendum to reinstate a lower usury ceiling in the state of Washington failed by over a [illegible] to 1 margin in November, 1982. Clearly, the competitive marketplace is working in those states where it is allowed to set an appropriate price for credit. If anyone were being overcharged or if credit prices rose to be out of line with neighboring states, legislatures would have been forced to reimpose interest rate caps. In fact, however, the marketplace functions better than legislated ceilings could ever hope to work, as evidenced by a recent study by the New York State Banking Commission.

In 1980, the New York State legislature passed legislation which eliminated essentially all interest rate ceilings in that state. The legislation mandates an annual report from the Banking Commissioner to assess the effect of the statute. The first report issued in early 1981 found that interest rates had risen since the passage of the bill, which was no real surprise since prior rates were unrealistically low. More importantly, however, it found that there was an increase in available consumer credit for New Yorkers. Banks were offering a wide range of rates and fees which provided consumers a broad market within which to shop for credit.

The survey was conducted again in late 1982. Responses were received from over 450 credit extenders including commercial banks, savings and loan associations, finance companies, retail stores and automobile dealers. The report issued in December of 1982 made the following major findings:

- There was a greater degree of competition among banking institutions for consumer lending.
- There was a wide variation in the rates charged by different institutions in the same market area for the same type of loans. Rates range from 14 1/2 to 20 percent depending upon the type and maturity of the loan.
- As market rates have fluctuated, so to have the rates charged on consumer loans.
- Creditors generally are using more liberal credit standards for consumer lending and offering larger credit lines. More institutions are participating in consumer loan activity.

It appears, therefore, that the average New Yorker is better off due to deregulation. The range of financing alternatives has been substantially broadened with more credit available at reasonable rates from more sources to a broader spectrum of potential borrowers.

Economic data support the contention that usury ceilings serve no useful purpose. Numerous studies have been done to test the effectiveness of usury ceilings. Remarkably, the vast majority of these studies have come to the similar conclusion that usury laws, while well intended, produce unintended and detrimental effects on consumers, lenders, markets and the economy. Empirical evidence consistently supports competitive market pricing as being clearly superior to legislatively imposed usury ceilings. One of the most recent compilations of data documenting the detrimental nature of usury ceilings is an article in the mid-year 1982 edition of Economic Perspectives published by the Chicago Federal Reserve Bank. The article entitled "The Effects of Usury Ceilings" analyzes several recent studies of the effects of usury ceilings and concludes:

> Economic research clearly supports the current legislative moves toward deregulation of usury ceilings. The evidence on the impact of usury ceilings shows that they have not achieved their objectives. According to the empirical studies surveyed, usury ceilings have significantly reduced the availability of credit and created hardships for those who were supposed to be protected. Ceilings have encouraged lenders to use such credit rationing devices as higher down payments, shorter maturities, and higher fees for related noncredit services, which increase the effective interest rate. They have curtailed the amount of credit available to lower income and higher risk borrowers, harming primarily those individuals whom the ceilings are intended to benefit. Finally, the lack of uniformity of usury laws across states has distorted credit flows and economic activity, favoring those states and regions which are less regulated. ["The Effects of Usury Ceilings" - Donna Vandenbrink, mid-year 1982 issue Economic Perspectives (page 44-55, 55) Pub. - Federal Reserve Bank of Chicago.]

The last sentence of that excerpt is most important. It emphasizes the interstate nature of the problem. Congress recognized and reacted to the barriers imposed by Regulation Q and in 1980 prescribed the framework for its removal. The 1980 Act also provided a permanent override of state laws that limit the amount of interest that can be paid on deposits and accounts. Congress obviously understood the need for pervasive federal action to achieve its goal of deregulated rates on deposits. The same logic applies when analyzing usury ceiling legislation. If all borrowers nationwide are to have equal access to reasonably priced credit, national action is necessary. Obviously, interstate creditors such as automobile finance companies, who must charge a low rate for loans in a particular state, make up for their losses in other states where there are no such restrictions. Farm implement manufacturers in Illinois, where there are no usury limits, suffer the effect of the restrictive limits which exist in Arkansas. Clearly, this is an interstate problem. Most banks do not have the luxury of interstate operations and are limited by home state laws. Thus, borrowers nationwide pay the price for the states that refuse to recognize the economic futility of usury ceilings. Congress, not the individual states, is charged under our Constitution with enacting laws to regulate interstate commerce. If individual states are unwilling or unable to address this problem, then it is the duty of Congress to eliminate these anachronistic barriers to the interstate flow of commerce. We therefore support Title VII of S. 2181.

9. Interest on Demand Deposits

Title VIII of S. 2181 (also introduced as S. 1975) would eliminate the prohibition against paying interest on demand deposits and would direct the DIDC to impose interest rate ceilings on demand deposits identical to those imposed on NOW Accounts. It would also require depository institutions to hold full reserves rather than partial, "phase-in" reserves against increases in demand deposits that occur after the effective date of this title which is 180 days after passage. The title also adds non-profit political committees and groups to the list of organizations eligible to hold NOW Accounts.

The ABA has supported and continues to support the deregulation of financial institutions in order to allow those institutions to better serve their customers. However, the Congress has long recognized that deregulation of deposit interest rates must take place in an environment that allows depository institutions to offset the resulting increase in interest expenses. Otherwise, deregulation of deposit interest rates could threaten the safety and soundness of our financial system. It would also force a disproportionate share of the adjustment burden on one or more groups of bank customers such as small business, consumer, and agricultural borrowers. For these reasons, we recommend deletion of Title VIII of S. 2181.

Four serious problems currently face commercial banks, limiting their ability to respond to pressures resulting from the recent deregulation of deposit interest ceilings. Resolution of these problems will create an environment in which banks may be better able to adjust to these increased interest costs. These problems include:

1. The inability of commercial banks to offer their customers a wider range of financial services and, thus, to compete with a growing number of organizations that can do so.

2. The unrealistically low usury ceilings imposed by some states.
3. The implicit tax imposed on all depository institutions by the necessity of holding required reserves in noninterest bearing form.
4. The large number of personal bankruptcies resulting from abuse of bankruptcy laws.

We believe that satisfactory solution to these problems must be in place before Congress considers permitting the payment of interest on demand deposits. We have already discussed the first three of these problems and indicated what we believe to be satisfactory solutions for each. The bankruptcy problem is addressed in legislation that has been approved by the Senate and by the the House Judiciary Committee. Once satisfactory solutions to these problems are put in place, consideration can be given to payment of interest on demand deposits.

Payment of interest on demand deposits will dramatically increase the cost of funds at commercial banks. At the end of 1982, demand deposits accounted for 21.7 percent of total deposits and 16.9 percent of total assets at commercial banks. Even subtracting uncollected balances and balances due from domestic banks on the theory that such balances will earn interest for the bank, net demand deposits still equal 12.1 percent of total assets of the commercial banking industry.

Some idea of the potential impact of paying interest on these balances can be seen in Table 1 which shows data for 3 hypothetical banks of different sizes. These hypothetical banks have been constructed using industry average data for banks of that general size class. Table 1 shows the increase in interest cost resulting from the payment of interest at a 7 percent rate on net demand deposits under 2 different scenarios. In the first scenario it is assumed that 100 percent of net demand deposits earn interest. In the second scenario it is assumed that only 40 percent of the demand deposit balances earn interest. Under the first scenario, the increase in interest expense at the middle size bank actually exceeds 1982 pre-tax income. Even under the second scenario, the increase in net interest cost ranges from 30 to 45 percent of the 1982 pre-tax income of these hypothetical banks. Obviously, payment of interest on demand deposits without any offsetting adjustments would have such a profound effect on commercial banks that it would threaten the safety and soundness of our financial system.

10. Credit and Debit Card Fraud

Our Association is very concerned with the problem of card fraud and counterfeiting. Ten years ago fraud losses in the bank card industry were not sufficient to cause great concern. However, in the last few years fraud losses have grown enormously. The combined losses of the VISA and MasterCard systems have grown from $11.7 million in 1972 to $125.8 million in 1982 — an increase of over 1,000 percent.

We are particularly concerned about the counterfeit and altered card losses. For the MasterCard and VISA systems, these losses have increased from a relatively minor $175,000 in 1978 to more than $25,000,000 in 1982. When these losses are aggregated with the losses involved in private label bank cards, retail cards, gasoline cards, and travel and entertainment cards, it is clear that the country is faced with major criminal activity that cannot be ignored. We strongly support the provisions of Title IX of S. 2181 dealing with card fraud and counterfeiting.

We are hopeful that the efforts that the industry is making will help to substantially reduce the current fraud and counterfeiting activities. However, in spite of the industry's best effort, the criminal element will always seek to be just one step ahead of the industry's latest technology or security procedures. As our methods for detecting and eliminating fraud become more sophisticated, so do the criminal activities designed to beat the system. Effective law enforcement is the only way to ultimately deter criminal activity.

As a result, the industry has determined to pursue some revisions of the federal law in this area. In addition to Title IX of S. 2181, we are supporting S. 1870, recently approved by the Senate Judiciary Committee. The bill would modernize the law and focus attention on this growing problem and would provide investigators and prosecutors with an additional statute specifically aimed at card counterfeiting and the organized groups involved in fraudulent counterfeiting. We view this revision as one part of the comprehensive law enforcement efforts which will be necessary to deal with this problem on a long term basis.

At the same time, we feel that amendments to the Truth-in-Lending law and the Electronic Funds Transfer Act are vitally needed to fill some obvious and immediate gaps in the current federal legislation contained in Title 15 of the U.S. Code.

In recent years, the emphasis in criminal activity has shifted away from taking advantage of isolated lost and stolen cards to the more organized criminal activities involving alteration and counterfeiting of cards. Unlike fraud committed with the use of lost or stolen cards, the schemes involving counterfeit or altered cards rely heavily on the use of valid account numbers. As a result, the trafficking in account numbers has increased dramatically. For example, account numbers are used in collusive merchants' schemes where valid account numbers are embossed on white plastic and used to imprint sales slips.

In spite of this and other counterfeiting schemes using primarily account numbers and not cards themselves as the means for fraudulent activity, the Truth-in-Lending law is not clear that misuse of these account numbers constitutes credit card fraud. At least one court has held that fraudulent use of an account number did not constitute the illegal use of a "credit card."

An additional enforcement problem has been raised in connection with the $1,000 limit contained in several of the subsections of Section 134 of the Truth-in-Lending law and Section 916 of the Electronic Funds Transfer Act.

Those subsections require that a minimum of $1,000 in money, goods or services be obtained within a one year period to create a crime punishable under the federal law. Case law is not yet clear whether these subsections require that the prosecutor show only that $1,000 in value has been obtained using card fraud or whether the prosecutor must show that $1,000 was obtained with a particular counterfeit, lost, or stolen card.

The provisions of S. 2181 address these two concerns in a very satisfactory manner and, in addition, make possession of counterfeit, lost, or stolen cards a federal crime where the requisite fraudulent intent is present and a nexus with interstate commerce exists. Consequently, we urge the Committee to move forward with this legislation as quickly as possible.

The industry recognizes that more criminal legislation is not a complete answer to the current problems and the problems we will face in the future. Indeed, legislation may represent only a small part of the solution. A large part of the responsibility for counterfeiting prevention falls on the industry. We described the extensive efforts undertaken by our industry under the auspices of ABA's Fraud Task Force in recent testimony on May 18, 1983 before the Subcommittee on Consumer Affairs.

Since card issuers are the most direct victim of fraud schemes (customer liability is often limited by law), efforts must begin with the card issuer. However, all parties must assume their share of the responsibility. Ultimately, the costs of fraud are borne by the consumer in the form of higher prices for credit or for the use of the card as a payment mechanism. We urge the Committee to move forward quickly with the proposed amendments to Title 15 of the U.S. Code.

11. Consumer Leases and Rental Purchase Agreements

Title V of S. 2181 is essentially the same as the legislation proposed by the Federal Reserve Board on March 31, 1983. The staff of the Federal Reserve Board has invested a great deal of time and effort in its attempt to simplify and streamline the disclosures required in a consumer lease transaction. While we have identified a number of areas where we feel improvements may be made, we feel that the Federal Reserve by and large has presented workable legislation which by its "plain language" approach makes the leasing transaction more understandable for all parties involved.

In 1980, when the Truth-in-Lending Act was substantially revised and simplified, the provisions of Regulation Z which at the time covered consumer leasing, were removed, segregated, and redesignated as Regulation M. No attempt was made at that time to simplify the Consumer Leasing Act along the lines of Truth-in-Lending. However, the pre-1980 Regulation Z and the current Regulation M suffer from some of the same infirmities which were addressed in the 1980 Truth-in-Lending simplification effort. Chief among these infirmities is a malady known as "information overload." The current Regulation M model disclosure forms for a consumer lease attempt to give the consumer too much information and make no attempt to segregate key disclosures from less important information. Title V of S. 2181 would address both these problems by reducing the number of disclosures and by segregating key disclosures into a "federal box" much as was done in Truth-in-Lending simplification. The current consumer leasing model disclosure form covers two standard pages and contains much information which the average consumer lessee in all probability finds to be of little value. The revised model disclosure form, however, as proposed by the Federal Reserve Board, is much shorter and more concise and contains a limited number of disclosures most of which will be useful and informative for consumers. We feel that this approach will be very beneficial.

Title V of S. 2181 is drafted in plain language. A number of states have passed laws mandating the use of plain language in forms and documents used within their jurisdictions. Perhaps most recently, the Commerce Department has initiated a Forum on Plain English to promote the benefits of drafting documents in a simple readable form. Our Association has been involved with the Commerce Department efforts since its formative stages early last year, and we applaud the Federal Reserve Board for their plain English approach in drafting this legislation. We feel that the simplified and reduced number of disclosures coupled with the plain language approach to both the statute and the disclosures, make this a laudable effort on the part of the Federal Reserve Board.

The proposed legislation would also include so-called "rental purchase" agreements within the scope of the Consumer Leasing Act. These agreements are typically entered into for the rental of personal property, usually a home appliance, and have no fixed duration. Usually they involve a monthly or weekly payment, each periodic payment renewing the rental agreement for a subsequent period, and it is typically agreed that upon completion of a fixed number of payments, title of the property will be transferred to the lessee. These agreements have heretofore not been covered by the Consumer Leasing Act because current law defines a "lease" as one having a duration of at least four months. Since rental purchase agreements have no fixed duration, they have not been covered. It appears that there may be a need for some required disclosure for these types of contracts, and indeed representatives of that industry seem to desire federal legislation.

In contrast to the so-called rental purchase agreement, an automobile lease typically involves an initial payment, a contractual liability to make a series of monthly payments, for 36 or 48 months, and, depending on whether it is an open-end or closed-end lease, the potential for some liability for the residual value of the vehicle at the end of the lease term. In addition, should the lease be terminated early, there is additional liability on the part of the lessee. An option to purchase the rental property at the end of the lease term may be a part of the agreement, although it certainly is not an integral part of the contract as it is in the rental purchase contracts.

In short, it seems to us that these are two very different types of transactions. The Federal Reserve Board, in drafting this legislation, has also recognized the distinction since the rental purchase agreements have not been melded into the leasing form, but instead basically have been classed as a separate category of contract with different disclosures. This being the case, it seems reasonable to us that every effort be made to maintain the distinction between these two types of contracts. Thereby, it will be evident that Congress determined them to be separate and distinct, if in the future, regulatory or legislative bodies endeavor to assess the merits of each of these types of transactions. It is our suggestion, therefore, that these rental purchase type agreements be treated in a separate title of the Consumer Credit Protection Act to insure their continued distinction from the consumer lease transaction. Such a separation would not be a difficult task since rental purchase agreements are already treated as an essentially separate entity within the proposed legislation. This separation would make it clear that Congress, after reviewing the merits of each, found them sufficiently distinct to afford each a separate title in the Consumer Credit Protection Act.

As I mentioned earlier, there are some areas of the proposed legislation which we feel might be improved or changed. I will attempt to briefly discuss each of these areas.

Inclusion of Lease Arrangers in the Definition of "Lessor"

The definition of "lessor" in the proposed legislation excludes from coverage persons who are merely lease arrangers. While we recognize this attempt to provide parity with the Truth-in-Lending Act, which excludes from coverage arrangers of credit, we feel that lease arrangers typically have a different relationship to the transaction in question and should be covered by the Act. The usual lease arranger with whom banks deal, is an automobile dealer. The dealer may actually "sell" the lease to the consumer and provide forms which name the bank as the payee/lessor of the automobile. Thus, in many cases, while the "lessor" in the legal documentation may be the lending institution, for all practical purposes the person making the disclosures and providing the lease forms to the consumer is the automobile dealer. It seems most appropriate to us that in such situations the dealer as "primary discloser" should be included within the scope of the Consumer Leasing Act.

Total Lease Cost

The proposed legislation would provide for segregated disclosures, and federal box form, of several items which are perceived to be of most import and value to consumers. These would include: total initial payments; total of periodic or scheduled payments; total end of term payments; and total lease cost. While the totals of initial, periodic, and end of term payments may be valuable to the consumer, the attempt to disclose the total lease cost may in fact mislead the consumer should he choose to rely on it.

Leases come in many forms. One lease may require a higher initial payment with lower monthly payments, another just the reverse with a lower start-up cost but higher periodic payments, yet both may have the same total lease cost as that term is defined in the proposed legislation. In such a situation, the total lease cost disclosure would certainly be misleading to the consumer since the lease with a higher initial payment would also have a higher opportunity cost of funds due to the higher outlay of cash at the front-end of the lease. While it may be preferable to some consumers to have lower monthly payments, even at the cost of the higher down payment, it certainly would be misleading to tell the consumer that the "cost" of both leases is the same.

In addition, to the extent that the periodic payments contain insurance premiums, taxes, or other official fees, all of which may be subject to change over the term of the lease, the total lease cost may be nothing more than an estimate. Use taxes, property taxes, registration and licensing fees all vary from year to year. This being so, their incremental cost cannot be known at the inception of the lease. Insurance premiums, which may be included in periodic payments, are equally as fluid and may be quite different by the end of the lease term. These variables, to the extent that they are included in the periodic payments, will render an assessment of the "total lease cost" at the front end of the lease nothing more than conjecture. Certainly to the extent that a required disclosure constitutes a guess as to what the total lease cost will be, it represents an opportunity for error on the part of the lessor in providing the disclosure, and another area for potential litigation and liability.

It should also be noted that inclusion of official fees and taxes or insurance premiums is optional. It is, therefore, entirely possible for two leases to have identical underlying costs for the actual vehicle lease but with widely disparate "total lease costs." If one lease includes the variables of insurance, taxes and official fees, and other other leaves them to be paid separately by the lessee, the "total lease cost" of the contract without the variables included will obviously be much lower, yet the actual out of the pocket outlay by the consumer could be much more. Furthermore, even if the proposed total lease cost disclosure were of value, it would be given at the time when it will be of little use to the consumer, since it will be provided at consummation. Consummation usually occurs when the lease is signed and by that time the consumer has already made the decision to lease.

Since a lease is a nonequity creating transaction, the total cost of the transaction is really irrelevant, except as a very loose comparison to the purchase alternative. Even that, however, is essentially an apples and oranges comparison since the purchase option includes interest deduction calculations and the intangible benefit of actually owning the property at the end of the contract, while a lease is merely a payment for the use of the property. Since this proposed disclosure is partially misleading, probably inaccurate, and definitely not material to the decision-making process, we submit that it should be eliminated and that the lessee be allowed to make his own evaluation of the cost of the lease based on the amount and timing of payments under the proposed contract.

Official Fees and Taxes

Title V of S. 2181 also proposes to require the disclosure at the inception of the lease of the total amount that will be payable over the term of the lease in official fees and taxes (assuming that these amounts are included in the monthly payment). The impossibility of such a requirement should be obvious. Registration and licensing fees change periodically. Tax rates change in concert with the fiscal needs of the governmental body imposing the levy, which in many cases can be with some regularity. In some areas where taxes are paid in arrears, the actual tax rate applicable to a piece of personal property may not even be known until several months after the lease is executed. Thus, to require the lessor to disclose these amounts three or four years in advance is manifestly impossible. The better approach, when fees or taxes are to be paid through the lessor, is simply to disclose the amount of the official fees and taxes currently included in the initial or periodic payment, to the extent that they are known, with the clarification that future payments will contain a similar component, although the size of the component may vary due to changes in the rate structure of taxes or fees. Such an approach would notify the consumer what he is paying now and alert him to the fact that future payments may change. This approach would accomplish the goal of consumer notification while relieving the lessor of the obligation of attempting to estimate future taxes or insurance rates.

Civil Liability

We applaud the revision of the statute of limitations provision which essentially limits disclosure liability to one year from the date of occurrence. Likewise, the class action damages limitation would be welcome relief from a formerly inequitable statutory scheme. We would, however, like to see the limitation of statutory damages to only certain of the most relevant disclosures under the proposed statute. Such an approach would be consistent with the simplification of Truth-in-Lending. It would also serve to reemphasize the importance of the limited number of the key disclosures to which statutory damages were applicable and to avoid penalizing lessors who may make a less critical error on a less important disclosure. Under the proposed statute, even these less critical errors would subject a lessor to the same statutory penalties as one who had failed to make any disclosures.

We, therefore, feel that liability for statutory damages should be limited to the disclosures required in the federal box (except the total lease cost disclosure which we feel should be eliminated), disclosure of security deposits, expiration liability disclosure, early termination liability disclosure, and the disclosure of the right to an independent appraisal upon termination. Limitation of the statutory damages provisions to these key disclosures would, of course, in no way limit liability for actual damages incurred by a lessee due to erroneous disclosure. Lessors would remain fully liable for any actual damages incurred by a consumer due to improper compliance with the Act.

Relation to State Law

Title V of S. 2181 would preempt only those state laws with which it is impossible to comply without violating a portion of the federal law. That is to say, it is a very narrow standard and under it most state laws would be unaffected. The problem with this approach is that multi-state lessors then have to develop compliance programs for each state with differing regulations, thus, imposing additional cost and expense. In addition, the problem of "information overload," again begins to loom large. If consumers receive both state and federal disclosures, confusion may be the only demonstrable result. We would, therefore, prefer to see a very broad preemption standard which would recognize the excellent work done by the Federal Reserve Board in determining what the most relevant disclosures are for consumers, and that would exempt lessors from making any state disclosures which are different from those federally required. In addition, we would prefer that anyone, not just a state, be able to ask the Federal Reserve Board for a determination of whether a particular state law is preempted. This approach would allow multi-state lessors to determine fairly quickly what the applicable law is in any given state.

12. Delayed Funds Availability

Deposit availability is an issue with which the banking industry is very familiar. It is a problem which is inherent in a system that relies on the physical movement of paper to call funds from distant accounts to the person possessing the paper. This is essentially what a check does. A check is not cash. It is an order to a bank to pay cash to the person who is the payee of the check. Until that piece of paper arrives at the bank on which it is drawn, no one is sure whether it will be honored as valid or returned unpaid for any of a variety of reasons. (Attachment 2 is a brief background paper entitled "Checks and the Delayed Availability of Deposited Funds", which gives a more detailed review of check processing.) It is this uncertainty which leads banks to place holds on deposited funds. If all people were honest or did not make mistakes as to the balance in their accounts, there would be no delayed availability problem. Similarly, there would be no problem if everybody took the checks they wanted cashed directly to the institutions on which they were drawn, where the decision on the validity of the check and available funds could be made on the spot. This, of course, is not possible given the convenience and universality of a national payments system with many thousands of financial institutions participating.

Senator Dodd, in his remarks in the Congressional Record upon introduction of S. 573, (Title VI of S. 2181), made reference to the policy of placing holds on checks. He stated: "In these days of electronic banking and automated clearinghouses, there is no excuse for these problems to occur with the frequency they do." Intuitively, it does seem rather incongruous that in a day and age where live television from outer space is common, and complex mathematical calculations can be done in fractions of a second on a computer the size of a credit card, that it can take up to several days to assure the validity of a check drawn on a bank in the next state.

Unfortunately, however, comparing space-age technology and automated clearinghouses with the check clearing system is a classic apples and oranges comparison. The development over the past several years of electronic banking and the automated clearinghouse for the rapid clearing of electronic payments has given banking a broad new ability to effect very rapid and positive transfers of funds. Statistics of the National Automated Clearing House Association show that from 1976 through 1981 the volume of payments made and recorded through electronic means increased by over 100 percent each year. Last year the volume increased by over 50 percent. Currently, over 350 million transactions are completed annually through automated clearinghouses. In addition, approximately three billion transactions are completed at automatic teller machines. The advantage to electronic banking is that it is very fast and is not subject to the delayed availability problem. For instance, if an employee takes his paper paycheck to the bank and deposits it, the bank may place a hold on it depending on who the employer is and who the employee/customer is, and their relationship to the bank. This is because the paper check must be sent back to the employer's bank to be sure that it is good. (This example assumes the employee and employer have different banks). On the other hand, if the paycheck is directly deposited by the employer via an electronic funds transfer to the bank account of the employee, it is and by federal law must be available to the employee for withdrawal on that payday. In the first instance, the employee has presented to the bank an order to the employer's bank (a check) which the employer's bank must then go out and collect. In the case of direct deposit, however, the employer's bank has electronically sent the money directly to the employee's bank.

The consumer has typically used the check as a means to obtain cash or as a medium of payment for goods and services. The banking industry, recognizing the weaknesses of the paperbased check system, has with the advent of electronic technology, moved toward alternatives which will offer convenience never attainable with a check.

There are currently over 30,000 automatic teller machines in operation in this country, a number which increases virtually every day. In the past few years, numerous regional and national systems have developed which electronically link these machines. These shared systems allow the consumer to use his own bank ATM card to get cash from any of a number of machines owned by various financial institutions throughout the region, state, or nation. We are already seeing media campaigns promoting these systems and banks who are members. Instant access to cash via an ATM has already become a common occurrence within a town or state. These systems will expand that availability and convenience geographically. It is already possible to make a coast-to-coast cash withdrawal which takes only a matter of seconds to process.

Similarly, there has been a move to point-of-sale terminals in retail establishments. These terminals use the customer's ATM card to instantly transfer the amount of the purchase from the customer's bank account to that of the merchant without any cash ever changing hands.

In each of these cases, the validity of the card, user, and the account balance can be verified electronically and the transfer effected immediately, thus eliminating the delay and uncertainty of a check.

The object of this rather lengthy discourse is to try and differentiate two separate and distinct payment systems which exist today. One is paperbased (check) and the technology upon which it is based (i.e., the transfer of paper among a series of individuals) can be traced back hundreds of years. The other, electronic funds transfers or electronic banking, is about 15-20 years old and like any teenager can do many things its grandfather cannot. I hope I have dispelled any confusion about the relationships between these two payment methods and illustrated that this issue of holds on checks is endemic to a paper based payment system. The Federal Reserve Board has over the past several months, for reasons generally unrelated to this issue, attempted to speed up its check processing system. While there has been some progress made, the requirement of physically moving the check through the system and back again if it is not paid, remains a time consuming process.

There is some prospect for improvement in the speed with which items are returned. The pilot project currently underway in the 11th Federal Reserve District (The Dallas Project) may offer significant reductions in check return times, and thus afford the opportunity of reduced hold periods on deposited funds. (See Attachment 2, "Checks and the Delayed Availability of Deposited Funds").

Banks have a public trust and a duty to manage funds to assure the safety and soundness of their institutions. If bankers allowed the immediate withdrawal of funds on a universal basis, many banks could be exposed to losses in excess of their capital should a number of them turn out to be bad. Such a policy would leave institutions wide open to "check kiters" who juggle worthless checks between accounts at various institutions and abscond with real dollars drawn on phantom balances. Clearly then, banks need to take some precautions to guard against losses from fraud and other types of dishonored checks. In fairness to our customers though, we owe them an explanation of why we do it and at least a general statement of our policy on the issue at the time the account is opened, with more specific information on individual items.

Our Association is concerned that consumers be made aware of the availability policies when they deposit a check drawn on a different financial institution. In fact, I think it is fair to say that our major difference with the disclosure objectives of Title VI of S. 2181 is with its intent to attain them through legislative and regulatory means.

Our industry has been very heavily legislated and regulated over the past half century. We are just now starting to shed some of these bureaucratic shackles, and are beginning to enjoy some of the freedom of the marketplace. We believe that the industry, on a voluntary basis, can, will, and in fact is in the process of implementing procedures which will accomplish the disclosure objectives of Title VI of S. 2181, without adding an additional level of legislative and regulatory control over financial institutions.

Attachment 3 is a mailing which was sent to every member bank in our organization in August of 1983. The cover letter from the President of our Association alerts our members to the seriousness of the problem, and refers to the attached policy statement and sample disclosure form. The policy statement is an example of a possible internal bank policy on placing holds on checks. Secondly, and more importantly to this Committee, is a sample disclosure form for when an account is opened.

This sample form clearly sets forth for the customer the reasons why there may be a delay in availability of their funds, explains when these holds may occur and gives a general rule on the length of any holds. There is further notice that specific information on individual items would be given upon their presentation for deposit. We would, therefore, in large measure accomplish the disclosure goals of Title VI of S. 2181.

In addition to the mailing which was sent to each chief executive officer, this issue has received prominent attention in Bankers News Weekly, our Association's weekly newspaper, which covers current banking news, and is sent to each member bank. The text of the sample policy statement and the sample disclosure form were featured along with an article reiterating the call for voluntary action.

The express goal of this voluntary program is to eliminate the need for legislative or regulatory initiatives. We feel we can do a better job given the flexibility inherent in a voluntary approach. A legislative proposal, no matter how innocuous it may seem on its face, in practice never functions in its intended manner. This is especially true when a regulatory gloss is added. An example which comes to mind is the simple and valid concept that lenders should disclose what interest rate they charge on loans. This simple sounding project was undertaken by legislators and regulators 15 years ago and today Truth-in-Lending represents one of largest and most complex federal regulations in existence. Over the years, the idea of a simple way of conveying the most relevant information to the consumer has been caught up in the cogs of the legislative and regulatory bureaucracy.

We are aware of the legislative efforts on this issue in both New York and California, which will mandate disclosure by financial institutions of their availability policies and require availability within a "reasonable" time. Both of these statutes are brand new. Neither law will be fully implemented until sometime later this year, thus, it is impossible to assess their effect at this point. Needless to say, however, we oppose any form of required availability schedule and feel, as discussed earlier, that a voluntary approach is the best solution.

Interest on Provisionally Credited Funds

The second portion of Title VI of S. 2181 would mandate the payment of interest on deposits in an interest bearing account as soon as provisional credit is received, as long as the check deposited ultimately turns out to be good. While we have no surveys or exact statistical data, it is clear from numerous forums where this issue has been discussed that the overwhelming majority of banks in this country begin to accrue interest (within the terms of the account agreement) as soon as provisional credit is received.

Even assuming there may be some banks who do not choose to pay interest at the time provisional credit is received, the question is raised as to whether this is a subject which is rightfully the subject of governmental proscription. What if these banks offer other services which are of far more value to the consumer than the diminished accrual of interest? Is it up to the government to make that judgment for the consumer? The market contains clear and viable alternatives for the consumer should he choose to exercise them. Given the existence of these alternatives, it certainly does not seem appropriate to regulate a market that is functioning quite well.

ANSI Standard

Title VI of S. 2181 would also require compliance with the check endorsement standard promulgated by the American National Standards Institute (ANSI). While compliance with this standard would certainly reduce errors in the return process by facilitating identification of the bank of first deposit and subsequent endorsers, it would in all probability not contribute to an acceleration of the return time of checks since this procedure still must be done manually.

During the development phase of the ANSI endorsement standard, there was some discussion of the adoption of a standard for machine readable endorsements. However, the final conclusion of the ANSI working group was to adopt a standard which was more closely compatible with existing technology.

It was hoped that such an approach might be more conducive to voluntary industry compliance. Despite this attempt to stay within the bounds of existing technology, there remain operational and technical problems for many of the larger banks in attempting to comply with the standard.

Direct Notification of Returns

Title VI of S. 2181 would also require the direct notification of the bank of first deposit when a check for over $250 reaches the bank on which it is drawn and it is not paid. The apparent intent of this provision is to short circuit the process of physically returning the check through all the banks that handled it before the bank of first deposit becomes aware that it has been dishonored. While this is a laudable goal, there are a number of operational and legal problems which would impact its viability. It is apparently assumed that this system would allow banks to release items over $250 after a much shorter period of time since the bank of first deposit would only need to wait until the check had reached the bank on which it is drawn. Once it reaches that bank, and the bank of first deposit does not get a telephone notice of dishonor, it could then be assumed to be good. However, what if the drawee bank fails to call? What if they call but the information gets mishandled internally? What if the check does not travel through the system in the usual time frame and thus, the notice of dishonor comes the day after you release the funds? What do you say to your customer when you take the $500 out of his account if you don't have a returned check in your hand stamped "insufficient funds"? What if the dishonoring bank calls the wrong bank or the wrong person at the bank?

All of these very plausible "what if's" will occur to the bankers of this country as well. Commercial practice and the uniform commercial code dictate that the way a check is returned is through the same order of intermediaries as its forward movement for presentment. Most bankers will not feel confident that the check is good until a sufficient number of days have passed to allow the actual return of the check. These fears of confusion or mistake are not without basis. Extrapolating percentages taken from an Atlanta Federal Reserve Bank study done in 1979, there are in the neighborhood of six billion checks processed each year written for amounts in excess of $250. While the overall average percentage of checks that are returned is about 1 - 1.5 percent, it may very well be that the percentage of returns is higher for these large dollar items. Thus, in addition to imposing an immense cost on the industry to make telephone notice of dishonor, this approach would also contain a substantial opportunity for error. We think it is fair to say that this provision, if enacted, would impose operational burdens and cost far out of proportion to the questionable value of the intended results.

In summary, it is the conclusion of our Association that Title VI of S. 2181 is not appropriate given the industry effort of voluntary disclosure and the existing widespread practice of paying interest from the date of provisional credit to the bank. In addition, mandated compliance with the ANSI check endorsement standard and requiring telephone notice of dishonor for checks over $250, could impose significant costs on our members, while having an insignificant impact on check return times or funds availability.

The existing competitive marketplace provides consumers with over 40,000 financial service providers from which to choose based on the range of services provided, including funds availability policies. We believe that the marketplace coupled with our voluntary disclosure program will address the concerns of Title VI of S. 2181.

13. Bankers Banks

Title III of S. 2181 would clarify the authority of national banks to invest in bankers banks. Bankers banks are organizations designed to provide correspondent-type services to those banks which own their stock. In recent years, these banks have been formed in a number of states to provide services to their shareholders. The National Bank Act was amended in 1980 and again in 1982 to clarify the Comptroller's ability to charter and national banks' ability to invest in limited-purpose bankers banks.

The provisions of S. 2181 relating to bankers banks are primarily designed to authorize bankers banks to be recognized as bank holding companies, subject to the full authority of the Federal Reserve System over such holding companies, in order to provide to their members services authorized for holding companies under the Bank Holding Company Act. In particular, bankers banks would be able to operate export trading companies.

Our Association supports these provisions of S. 2181. We believe that bankers banks provide a useful alternative to allow banks to join together to provide services for themselves which individually they may not be able to provide. Engaging in such activities as forming export trading companies requires a level of sophistication and capital resources beyond that available to many smaller banks. Through the formation of bankers banks, smaller financial institutions could pool their resources to form an export trading company directly or could joint venture with larger financial institutions or nonfinancial institution traders to engage in this activity. Our Association supports the enactment of the provisions of Title III of S. 2181.

14. Interstate Banking

S. 2107 introduced by Senator D'Amato, S. 2113 introduced by Senator Mattingly, and Title X of S. 2181 relate to the issue of geographic limitations on banking. While our members are very aware of the growing importance of the question of where banks should be allowed to operate, we believe this matter should be considered after resolution of the questions of what is a bank, who should be allowed to own a bank, and what products and services banks should be allowed to offer.

Table 1

PARTIAL IMPACT ON THREE TYPICAL BANKS OF INTEREST
ON DEMAND DEPOSITS [1]

	Bank A $ Millions	Bank B $ Millions	Bank C $ Millions
Total Assets	50.00	200.00	4,000.00
Total Demand Deposits	9.26	41.15	612.20
Net Demand Deposits	7.06	31.29	419.81
Potential Increase in Interest Expense, Scenario 1: 100% of Demand Balances Earn Interest	0.49	2.19	29.39
Potential Increase in Interest Expense, Scenario 2: 40% of Demand Balances Earn interest	0.20	0.88	11.75
1982 Pre-Tax Income	0.64	1.93	29.63

[1] Banks A, B, and C are hypothetical banks created by assuming that the balance sheet and income ratios for the $50 million bank are equal to the weighted average ratios of all banks with assets between $0 and $100 million as of December 31, 1982; that the ratios of the $200 million bank are equal to the average for all banks with assets between $100 million and $1 billion, and that the ratios of the $4 billion bank are equal to the weighted average ratios of all banks over $5 billion.

[2] Net demand deposits are gross demand deposits less cash items in the process of collection and demand balances due from domestic banks. It was assumed that interest would be paid only on collected balances and that interest would be earned on due froms.

[3] Assumes that the rate paid is 7%.

Attachment 1

CORPORATE SEPARATENESS AS A TOOL OF BANK REGULATION

Samuel Chase & Company
Washington, D.C.
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Preface

This independent study was prepared for the Economic Advisory Committee of the American Bankers Association. The authors are indebted to a number of readers for comments. In particular they wish to acknowledge the suggestions of J. Richard Zecher, P. Michael Laub, J. Denis O'Toole and John Prather Brown. Notwithstanding these helpful criticisms of earlier drafts, the authors alone are responsible for the accuracy of the facts and opinions expressed herein.

Samuel Chase
Donn L Waage

I. Introduction

The financial services system is being transformed much more rapidly than the regulatory framework that has grown up around it. Changes in communications and information technology, high nominal interest rates, and increased sophistication of customers have increasingly led nonbank firms to offer services formerly thought to be the domain of banks alone. Banks and their affiliates in turn are becoming increasingly well-positioned to offer services that transcend the historical boundaries of deposit-banking.

The tide cannot be pushed back. Once secure niches of profitability are now open to competition on new terms. Regulation must be streamlined if it is to serve its legitimate public purposes, including the safety of depositors' funds and equitable competitive opportunities for banking organizations.

The problems raised by the current system of regulation of banks holding companies may be summarized as follows:

1. Historically, banks have been heavily regulated. The purposes have been (a) to protect the interests of depositors and public insurance funds, (b) to assure a smoothly functioning payments system, and (c) to prevent a loss of confidence in financial institutions.

2. As a natural response to credible regulation for safety and soundness, depositors and other bank creditors have tended to relax their guard. The resulting reduction of private market "policing" of banks has in turn increased the need for further public intervention in the form of "prudential regulation."

3. Increasingly, technological change has broken down what once were workable regulatory distinctions between what banks and their affiliates, including

nonbank subsidiaries of bank holding companies, could and could not do. As a result, banking regulation that might once have been appropriate has become too heavy-handed. Furthermore, recent high nominal interest rates have encouraged nonbank institutions to perform more bank-like functions.

4. To the extent that the Federal Reserve administers the Bank Holding Company Act as if bank holding companies require the same heavy dose of prudential regulation as that administered to their banking subsidiaries, the regulatory apparatus becomes increasingly oppressive. This all but assures that regulation will continue to become more inefficient, and to cause functions that might best be performed by banks to be driven into the less regulated nonbank sector.

One of the most promising ways to cut through the tangled web of over-regulation is to adopt a streamlined regulatory strategy founded on the legal doctrine of "corporate separateness." Such a strategy can permit banking organizations to expand the scope of their activities without automatically drawing all of them into the net of prudential oversight. This strategy is embodied at least partially in the Administration proposal now before Congress, S. 1609, which would broaden the scope of permissible activities for bank holding companies and, at least to a limited degree, restrain Federal Reserve intervention in the activities of nonbank affiliates of banks are concerned. For details of the Administration proposal, see Appendix A.

What Corporate Separateness Means

According to the separateness doctrine, if two or more corporations are affiliated (i.e., have common ownership) the fact that one encounters difficulties does not imply a legal obligation on the part of the others to come to the rescue. Using the separateness approach, it ought to be possible to permit corporations engaged in other activities to own banks as well, without requiring the regulators to attempt to oversee nonbank activities in the manner that banking activities are supervised. Rather, these activities would be "regulated" by market forces or, where appropriate (as in insurance underwriting) by the regulatory authorities charged with oversight of the nonbank activity in question. For example, a separate consumer finance company subsidiary of a bank holding company would have to meet the same standard tests of market discipline in arranging its finances as would a finance company subsidiary of Gulf + Western.

Under such a regime, organizations that now perform banking functions could, subject to market "approval," expand and innovate. Other financial institutions could move into the business of deposit-taking by acquiring banks, with maximum responsiveness to new opportunities and needs and minimal risk to the public requirement for safety of deposits. A more extended discussion of the relationship of this notion, in the framework of the theory of corporate finance as set forth by Franco Modigliani and Merton Miller in their classic 1958 article "The Cost of Capital, Corporation Finance, and the Theory of Investment,"1/ is presented in Appendix B.

Counterarguments

The "separateness approach" makes traditionalists uneasy. Their criticisms fall into three broad classes. The first is that corporate separateness will, as a general rule, break down on legal grounds. As will be shown below, there is little if any merit to that position.

The second criticism is that whatever may be the legal niceties involved, any well-operated bank would in fact move to bail out a failing affiliate unless the costs of doing so were nearly certain to be fatal to the bank. This argument has some factual support, and a great deal of intuitive appeal. But it ignores the importance of statutes, regulations, and supervisory measures that limit intercompany transactions.

The third criticism is that no one -- especially bank depositors -- would believe in such a system. That is, if Bank Holding Corporation, sole stockholder of Zenith National Bank, owned a mortgage banking company that was legally separate from the banking subsidiary, depositors and others would lose faith in Zenith National Bank if the mortgage banking firm failed. This, it is argued, would bring about a run on Zenith National Bank, very possibly causing it, too, to fail. This argument has some historical backing and great intuitive appeal, at least to some regulators. Most importantly, the Federal Reserve, by its own choices of supervisory policy and many written statements has indicated that it believes the argument. And in financial matters, the Federal Reserve's opinions are often given great weight. This point is important: the Fed has given its general backing to S. 1609 but only after extracting major changes in the original version of the Administration bill -- changes that would permit substantial continued Federal Reserve prudential oversight of the financial affairs of banks. That is, the Federal Reserve has, in substantial measure, rejected the use of corporate separateness a reliable device for bank regulation.

Outline of the Remaining Sections of this Paper

It goes without saying that the workability of separateness ought to be judged with great care before it is made the cornerstone of a revised regulatory policy. It is important to get the debate focussed on the specific issues, rather than to resort to sweeping generalizations. This paper, therefore, takes up the major issues listed above one at a time. Section II deals with the legal doctrine of corporate separateness; Section III treats practical aspects of corporate separateness, including historical experience, the importance of statutes governing the relationships between banks and their affiliates, and what little we feel can be said on the subject of potential runs on banks with troubled affiliates; Section III reviews some relevant experience from another area -- the prudential regulation of insurance companies; and Section IV looks at three related issues that tend to be raised when the separateness approach is proposed. These related issues are (1) whether banking organizations are competent to engage in nonbank activities; (2) whether small banking organizations should be afforded treatment different from that given larger ones; and (3) whether municipal bond underwriting (including revenue bonds) ought to be required to be conducted by affiliates, rather than directly by banks. Finally, Section V summarizes the central issue.

II. Legal Considerations Relating to Corporate Separateness

If the Administration proposal is to be accepted, a necessary condition is that its conceptual foundation -- that banks can, as a matter of law, be insulated from risks taken by affiliates -- be correct.

General Principles of Separateness

A fundamental principle of corporate law is that a corporation is a legal entity distinct and separate from its shareholders.[2] This corporate concept is used throughout the Western world. The separateness aspect of incorporation has been given a great deal of credit for encouraging productive investment, as shareholders can normally feel confident that the risk they run is limited to the amount that they have invested.

As a legal matter, even when the only shareholder of a corporation is another corporation, the principle of separateness applies.[3] A holding company is the classic example of a corporation that owns stock in other corporations but is treated as a legal entity separate from its subsidiaries.[4] Similarly, each member of a group of sister subsidiaries of a holding company is a legal entity separate from both its parent corporation and the other group members.[5] Creating a subsidiary corporation for the specific purpose of limiting the liability of the parent, moreover, does not in itself justify disregard of the corporate entity.[6]

There is no suggestion in case law of any recent change in the basic legal principle of corporate separateness.[7] There have, to be sure, been instances in which a corporation has been held liable for debts or acts of one of its affiliates. Although such cases are very unusual, it is important to understand them in order to gain an appreciation of the circumstances under which separateness might prove to be a useless regulatory tool.

Types of Exceptions

A party asking a court to hold one corporation liable for another's debt can proceed under either of two legal approaches. The first involves extending corporate liability from one corporation to another on the basis of relationships. The second involves "piercing the corporate veil," i.e., finding that two entities are not, as a matter of law, separate. With respect to the first class of exception plaintiffs seeking to recover claims against one corporation from another affiliated corporation often allege that a relationship beyond that of typical affiliation has existed between the corporations. There are a number of possibilities, including the following:

1. If a subsidiary acts as an agent of its parent, it might be held liable for the parent's debts under the law of agency.8/
2. If a party contracts with a subsidiary corporation but reasonably believes that the parent is a party to the contract, then the parent may be held to that contract.9/
3. If directors who are common to two corporations act to benefit one corporation at the expense of the second, thereby harming creditors of the "milked" company, then the first corporation could be liable for its "unjust enrichment."10/
4. If one corporation represents that it stands behind a second, and if a third party, believing this representation, is harmed because he relied and acted on that belief, the court may require the first corporation to make good on the liabilities of the second.11/

The second class of exception has arisen on occasion when courts have decided simply to disregard separateness, i.e., to "pierce the corporate veil." The major factor in such decisions has been a judicial conclusion that the affairs of one corporation are so intermingled with those of another that the concept of separateness is meaningless.

The factual situations in cases involving "piercing the veil" are quite varied. Several commentators have attempted to categorize them: one analyst, Harry Henn, suggests that there are three classes of cases in which corporate separateness is likely to be disregarded.12/ The first is when affiliated corporations are used for an illegitimate purpose. The second is when corporate separateness is not observed by the affiliated corporations themselves (for instance, when there is either an intermingling of business between them or a failure to maintain certain formal requirements of corporate law; or when two corporations have led the public to believe that the companies are in effect one and the same). The third is when a subsidiary corporation is inadequately capitalized.

All of these abuses must, of course, be prevented if separateness is to be used as a weapon in the arsenal of bank regulation. But it should be stressed that in every case the "abuse" is the exception, not the rule. In a well-known law review article published in 1979 Douglas (later Mr. Justice Douglas) and Shanks claimed the following four standards would keep affiliated corporations from being treated as a single entity:

1. Each corporation should maintain separate finances and should be "sufficiently financed so as to carry the normal strains upon it."
2. The day-to-day business of each corporation should be kept separate with records similarly kept.
3. The formal barriers between the management structures should be maintained. For example, separate board meetings should be rigidly adhered to.
4. The two units must not be represented as one.[13]

Separateness Applied to Banking Organizations

It might be thought that banking presents a special case, in the sense that corporate separateness is not fully applicable to that industry. This is not so. Extensive research indicates there are few cases in which the courts have disregarded corporate separateness in banking. These exceptions fall almost exclusively into two categories, namely double liability on bank stock and attempts to stop bank expansion. Each of these areas of exception is discussed below.

Double liability on bank stock, a statutory requirement to assess bank stockholders an amount equal to the par value of their stock in the event the bank failed was once common. It was a response by both Federal and state legislators to the need to protect bank depositors. Most state laws were enacted in the early 1900's and were repealed following the establishment of federal deposit insurance in 1933.[14] National bank stockholders were subject to double liability until 1933, and to a very limited degree until 1953.[15]

Soon after passage of the early double liability statutes some banks discovered they could use the principle of corporate separateness to avoid double liability for their stockholders. The practice was simply to create a holding company to own the bank. In the event of a bank failure double liability was assessed on the holding company as stockholder but the holding company, having no assets except the bank stock, could not pay the assessment. Thus, stockholders of the holding company could still control the bank but were isolated from double liability.

Receivers of failed banks often asked courts to disregard corporate separateness and make holding company stockholders liable. At first the courts upheld the legal separateness of banks and their holding companies except in cases involving egregious violations of morality or financial prudence. Eventually, however, due to the ease of forming holding companies, their potential for evading the law, and the policy issues involved in bank failures, courts began to disregard separateness and to impose double liability on holding company stockholders. But even until the mid-1930's there were some courts which rarely disregarded corporate separateness in such cases. In any event, this area of exception does not appear to be relevant today.

Attempts to stop bank expansion constitute the second class of cases unique to banking. These cases arose in the 1960's and 1970's, a period of rapid growth through branches, bank holding companies and new bank charters. Opponents of bank expansion claimed that acquisitions of more than one bank, either by holding companies or persons or groups that controlled more than one bank charter, violated state branch banking laws.

One of the earliest such cases, First National Bank of Billings v. First Bank Stock Corp.,[16] established the test of "unitary operation" that has generally been applied in later cases. Under the unitary operation test the court can disregard separateness to find an illegal branch in a holding company only if it finds the affiliated banks are doing business as instrumentalities of one another, which was not so in this case. Research for this paper turned up only one case, Whitney National Bank v. Bank of New Orleans [17] in which opponents succeeded in establishing that one proposed holding company bank would be operated as an instrument of another. (This case was later reversed on other grounds.)

Competitors have also sought to prove that acquisitions by subsidiary banks were in reality acquisitions by the parent holding company. These cases have failed as courts have relied heavily on distinctions in statutes between holding companies and banks.

The courts have also been asked to find that new charters granted to individuals owning one or more existing banks would constitute the operation of a branch system in violation of state statutes. Opponents have typically claimed that commonality of ownership, directors and provision of bank services were evidence enough to disregard corporate separateness and to find multiple charters to be illegal branching. Among the reported cases we have found, none was successful.

Conclusion

There is no reason to doubt that, as a legal matter, the principle of corporate separateness is workable in shaping a new regulatory strategy. Based on our review of both court cases and the literature, we believe that if separateness is to be used, these principles should apply:

1. Representations by the parent and its subsidiaries should not imply that individual entities are but divisions of a single corporation.
2. Care should be taken to ensure that creditors understand when they are extending credit to only a single unit of the holding company.

3. Each subsidiary should be appropriately capitalized.
4. Neither the parent nor its subsidiaries should engage in fraudulent conduct toward creditors or minority stockholders of subsidiaries.

III. Practical Insulation [18]

Whatever may be the legal status of banks as separate corporate entities, the practical achievability and indeed the desirability of insulating banks from the misfortunes of nonbank affiliates is often questioned. There is a widely held (and probably correct) view that in practice banks and bank holding companies would rarely want to "walk away" from financial disasters that afflicted any of their affiliates. Rather, to the extent that law and regulation permitted, they would deploy available resources available from other members of the corporate family to prevent the failure of any other member. And history shows that in extreme situations, some organizations will violate legal and regulatory restrictions on intercompany transfers of funds.

Past Experience

A number of experiences provide reason to consider this issue seriously. Two cases involving financial companies merit particular attention. In 1963, American Express Company assumed liability for claims against its subsidiary, American Express Warehousing, Ltd., that arose out of the "salad oil scandal." This episode found the warehousing company, whose capital was about $100,000, subject to claims in the neighborhood of $60 million. The claims related to warehouse receipts it had issued for oil that was supposedly stored in tanks but that turned out not to be there after all.

In 1969, United California Bank assumed responsibility for debts of its Swiss subsidiary, United California Bank of Basel, after the Swiss bank had suffered debilitating losses mainly connected with illegal use of its resources for speculation in cocoa futures.

The willingness of both American Express and United California Bank to assume responsibility for the liabilities of their subsidiaries may have been partly a matter of managerial pride. But managements are, in the end, answerable to shareholders, and in both of the cases cited above, it appears that bailing out failing subsidiaries was good business judgement. After the salad oil episode, Howard L. Clark, President of American Express, stated:

> Our success is based on good will and belief in our integrity and soundness. The immediate acceptance of travelers checks, money orders, credit cards, and the maintenance of bank deposits are all a basic necessity to the prosperity of the company.19/

There are, of course, also numerous instances in which corporations have "walked away." For example, in 1968 the Raytheon Company's Italian subsidiary, Elsi, declared voluntary bankruptcy.20/ By no means, however, would the authors contend that managements can be expected to be attracted to this option as a general matter.

Statutes, Regulations and Supervisory Practices

Let it be stipulated that in a sizeable fraction of cases where financial problems afflicted nonbank affiliates of banks (i.e., parent holding companies and sister subsidiaries engaged in "nonbanking" activities), managements would judge that the welfare of the entire organization would be served by diverting resources from banks to aid the troubled affiliates. It then follows that if banks or depositors require special government protection, statutes and regulations will be needed to ensure that banking resources are not misallocated. In addition, supervisory methods will have to be up to the task of policing intercompany transactions.

These are matters of legitimate concern to all who are involved in the evolution of bank regulation. Basically, they boil down to "milking" banking subsidiaries, inappropriate use of the discount window, and any related misuses of banking resources. The following paragraphs deal with statutes, regulations, and supervisory practices employed to guard against such abuses.

Restrictions on Intercompany Transactions. Section 23A of the Federal Reserve Act limits the ability of banks to make loans to, and purchase assets from, their affiliates. Loans of an insured bank to an individual nonbank affiliate may not exceed 10 percent, and loans to all nonbank affiliates combined 20 percent, of the bank's capital and surplus. (Normal transfers of funds among affiliated banks are excluded from this limitation.) Further, with certain exceptions, loans from banks to their nonbank affiliates must be secured by collateral of types specified by statutes, and such collateral must have a market value in excess of the amounts of any such loans. S. 1609, the Administration's bill to reform bank holding company regulation, would add a new Section 23B imposing further requirements by mandating that the terms of intercompany transaction be arms-length, i.e., the equivalent of those that would be available to a third party.

In addition, the Federal Reserve Board has broad cease and desist powers which can be used to block unsafe or unsound transactions among units of a holding company. Federal regulators of banks (i.e., the Federal Deposit Insurance Corporation, the Comptroller of the Currency, the Federal Reserve, and most if not all state bank supervisors) have similar powers with respect to the banks under their respective jurisdictions.

Dividend Restrictions

Bank dividends are limited by Federal and state laws. National banks must request approval from the Comptroller of the Currency before paying dividends out of capital and surplus, or paying dividends in any one calendar year in excess of the sum of net profits for that year and retained net profits for the two preceding years.[21] The Federal Reserve Act imposes identical restrictions on state member banks, which must seek their approvals from the Board of Governors.[22] State banking laws differ, but most if not all restrict payment of dividends out of capital, and at least some limit dividends in much the same way as does Federal law.

Solvency Ratio Tests

In addition, supervisory authorities (including the Federal Reserve, the Comptroller, the FDIC and state banking commissions) apply pressure on banks to maintain adequate capital. In December 1981, formal capital ratio guidelines were issued by the three Federal bank regulatory agencies, and in June 1983 the guidelines of the Federal Reserve and the Comptroller were extended to cover the nation's largest banks, which had not been covered by the December 1981 standards. The Federal Reserve, it should be noted, employs similar guidelines for bank holding companies on a consolidated basis, consistent with its regulatory philosophy of treating holding companies essentially as if they were banks, rather than separate corporate entities less in need of the benefits of public oversight.

In sum, although a thoroughgoing analysis might show more statutory protections are needed to assure that bank holding companies do not cause banking subsidiaries to make harmful diversions of funds to nonbank affiliates, it seems that the regulatory tools at hand are, on the whole, sufficient.

Usefulness of the Holding Company as a Regulated Entity

It will, of course, always be possible for those who own and control banks to abuse them, whether the owners are individuals or holding companies. At least three of the four largest bank failures since the 1930's appear to have involved serious diversions of bank resources to further the ends of the owners. Interestingly, however, in two of the three cases, the banks that failed were not owned by holding companies.

It is important to keep in mind that, under the powers vested in it by the Bank Holding Company Act, the Federal Reserve requires all bank holding companies to file regular reports of intercompany transactions as well as periodic consolidated financial reports and detailed annual reports. It also has in place a program of regular holding company inspections. Thus, the fact that bank holding companies themselves come under the Federal regulatory umbrella, whereas unincorporated owners of banks do not, gives reason to foster formal holding company affiliation, as opposed to informal ties between banks and the nonbank affairs of their owners.

Public Perceptions

It is often argued that whatever may be the facts as to law and regulation, failure of a parent company or other nonbank affiliate could cause a run that would be fatal to any bank regardless of its own financial condition. A good example of the broad sweep of such generalizations is given by a Federal Reserve

Board staff document sent to Reserve Bank examiners last year in connection with the implementation of the Board's new capital guidelines:

> While the ratio guidelines are to be applied to both the bank and its holding company, it should be borne in mind that it is the consolidated entity whose financial condition and strength will ultimately determine the fate of the bank subsidiary.23/

We disagree. As a general matter, if a bank is properly managed and supervised, it ought to be able to handle any liquidity problems that might arise because of trouble in affiliates through access to the Fed's discount window. To be sure, a holding company could get into so much trouble that it would have to sell one or more subsidiary banks, and indeed this has occurred. But sales of assets are standard procedures for financially-pressed companies and there have been several successful sales of banks by financially-pressed holding companies.

Moreover, the markets are already at work nurturing analytical distinctions of the type needed to make corporate separateness a useful strategy of regulation. Professional lenders to banks and bank holding companies, and those who advise such lenders, seem generally to be quite aware of the distinction between the two. For example, the major rating agencies typically give the long-term debt of bank holding companies lower ratings than they do the debt of the lead banks of the same holding companies, and the debt markets show a similar capacity to distinguish when it comes to establishing risk premiums.

For smaller holding companies, of course, both debt ratings and publicly traded debt are uncommon. In these cases, banks and other financial institutions are particularly important lenders. The lending departments of major banks analyze their bank holding company borrowers with a careful eye to the fact that banks' resources are not generally available to assist troubled affiliates. Similarly, insurance companies and other takers of privately placed debt treat the differences between debt of banks and that of bank holding companies with care.

These marketplace distinctions would be sharpened if regulators would take a clearer policy stance, indicating that their sole concern is for the safety of depositors (or alternatively of banks) and does not extend to the welfare of investors in companies that own or are otherwise affiliated with them. This would be a useful step, since the sheer complexity of the problems faced in the supervision of banks _per se_ argues for keeping responsibilities of the agencies within manageable proportions. Pushing more of the task of "regulation" of the financial affairs of bank holding companies onto the shoulders of private lenders and investors is an attractive strategy for coping with a fast-changing world.

Practitioners of bank supervision are, quite naturally, conservative, and likely to oppose radical change. Public policy, however, must be governed by a recognition that the bank regulation apparatus is sorely strained, and that alternative ways to promote given objectives should be considered with care. The next section indicates that experience in the regulation of insurance companies is relevant to an assessment of the workability of separateness in the protection of banks from problems of affiliates.

IV. The Insurance Experience

Insurance, a major part of the financial services business, has been affected by many of the same forces of change as has banking. There have been striking parallels between the two industries in terms of the effects of changing technology and business practices.

During the late 1960's, when one-bank holding companies emerged as significant forces, insurance holding companies were doing the same. Federal regulation of one-bank holding companies came in 1970 when Congress extended the Bank Holding Company Act of 1956 to cover them. Insurance is regulated almost exclusively by the states, and the modern landmark in regulation of insurance holding companies came in April, 1969 with the passage of the New York Insurance Holding Company Act.24/ The National Association of Insurance Commissioners developed model bill from the New York law which has now been enacted in 44 states and the District of Columbia.

A principal concern of policymakers, both in insurance and banking, has been the possibility that financial resources of the regulated entities might be diverted into unregulated areas. In response to this threat bank holding company regulators developed a policy of attempting to oversee all activities; insurance regulators took the opposite tack.

Insurers have had long experience with the concept of separateness. For years life insurance companies have maintained separate accounts for certain customers that cannot be intermingled with their general assets. These separate accounts are not subject to the strict investment limits applied to general funds of insurance companies.

New York became the model for modernized regulation that places heavy dependence on corporate separateness. The New York law makes separateness a key stategy of public policy, and is enforced with tough controls on transactions among affiliated companies, examinations and advertising. The public policy in favor of separateness is stated clearly in the statute:

> the insurer shall be managed so as to assure its separate operating identity....25/
>
> The business operations, corporate proceedings and fiscal and accounting records of subsidiaries organized or acquired... shall be conducted or maintained so as to assure the separate legal and operating identities of the parent and subsidiary....26/

New York law is very strict with respect to inter-affiliate transactions; there is virtually continuous reporting of such transactions. All transactions must meet standards of fairness and those whose value exceeds one-half of one percent of the insurer's assets require approval of the state commissioner.[27] Other states where similar insurance holding company laws are in place allow the commissioner to rescind transactions between affiliates.[28]

New York regulators are authorized to examine all aspects of an insurance holding company that may affect the insurer. Examinations also extend to inter-affiliate transactions. Furthermore, all unusual inter-affiliate dealings are ultimately scrutinized by the National Association of Insurance Commissioners.

Finally, the New York law limits the public identification of regulated insurers with their unregulated affiliates through restrictions on common names and advertising. Statutes specifically provide that the names of corporate subsidiaries may not mislead or deceive the public.[29] Announcements which contain a statement of the separate financial condition of the holding company system must also contain a separate financial statement for the insurer. And consolidated financial statements of the insurer and one or more subsidiaries may be used only to the extent authorized by the commissioner.[30]

The corporate separateness approach appears to work quite satisfactorily in insurance. This is not to say that insurance companies cannot fail, even as a result of misapplication of funds for the benefit of corporate affiliates. But strict control of transactions with affiliates appears to be a reasonably satisfactory method of combatting misuse of resources. More is said on this subject in the conclusion of this paper.

V. Miscellaneous

If a separateness approach to regulation in banking is to be adopted, a variety of related issues arise. We cannot attempt in this paper to cover all of these ancillary issues. This section deals briefly with four that might figure importantly in future debates. The first is the argument that bank holding companies, judged by the record, typically perform poorly when they undertake nonbank activities. The second relates to special provisions for smaller banking organizations. The third concerns policy toward savings and loan holding companies and the fourth relates to expanded bank powers to underwrite revenue bonds.

Ability of Bank Holding Companies to Manage Nonbank Businesses

It is frequently argued that the record demonstrates that bank holding companies are inept performers in nonbanking activities, and that for this reason expanded activities should be discouraged by statute and regulation. A number of studies have attempted to evaluate the performance of bank holding company subsidiaries relative to that of other firms in the same lines of business. They generally conclude that the performance of bank holding company subsidiaries is inferior to that of firms not affiliated with banks.[31]

It is not easy to assess the accuracy of these findings, partly because they are usually based on studies by agency staff using old data (mid-to-late 1970's) not available to the public, and partly because they entail complex hypothesis-testing. More fundamentally, however, the published studies are not suited to the purpose of judging the efficacy of corporate separateness. The question at issue is not how well bank holding companies perform their nonbank activities under the current regime, but whether bank holding companies would perform in a more socially useful manner if they were given more freedom and, simultaneously, their creditors and owners were put on clear notice that the Federal government's interest lay exclusively in protecting banking subsidiaries.

Put another way, given the Federal Reserve's policies of extending prudential regulation to holding companies, there is no way to test accurately the ability of the credit markets to discipline holding company activities. But it seems reasonable to presume that private investors in debt and equity can deal with risks of nonbank activities whether they are performed by bank holding companies or others, and that this will happen if the risks borne by such private investors are delineated with sufficient clarity. Studies of past performance under a regulated regime are of dubious relevance at best. Perhaps the most disconcerting implication of the agency staff studies is that they seem to endorse the notion that as the revolution in financial services continues expansion, rather than containment, of the prudential regulation of nonbank activities of banking organizations best serves the public interest.

The Small Bank Question

It has been argued, perhaps correctly, that use of the separateness strategy of regulation would work to the disadvantage of small banks, owing to the expenses involved in forming a holding company to perform new nonbanking functions.

There is, of course, no legal reason that separateness cannot be maintained by carrying on expanded activities through subsidiaries of a bank as well as through nonbank subsidiaries of a bank holding company. Indeed, in the insurance industry this approach appears to work well. Of course, for legal separateness to be effective the affairs of subsidiaries must be conducted separately from those of the parent, and creditors must be aware that they are dealing with separate legal entities. Smaller organizations which do not maintain separate staffs for the conduct of nonbank activities would probably have to work harder to convey the necessary perception of separateness, either between and among a holding company and its subsidiaries or between banks and their subsidiaries.

Still, the proper use of service corporation subsidiaries would offer most of the advantages that have been cited for the separate holding company affiliate. Under current law (part of the 1982 Garn-St. Germain Act) service corporations are permitted to derive only limited funds from their parent banks. The rest must be raised from outside investors who should be notified both that the obligations of bank service corporations are not guaranteed by their parents and that the law restricts transactions between service corporations and their parent banks in much the same way that Section 23A of The Federal Reserve Act restricts transactions between banks and their other nonbank affiliates.

A possible shortcoming of the service corporation approach is that, as a matter of day-to-day practice, bank regulatory officials would be more likely to attempt to extend the reach of detailed oversight to activities of subsidiaries of banks than to those of a holding company, assuming that the proposed strategy had been adopted. At least two reasons suggest themselves: (1) to protect the value of the investment of the parent bank and (2) "regulatory creep" or regulation for its own sake.

On balance, it would appear that should bank service corporations, as opposed to nonbank subsidiaries of bank holding companies, be permitted to expand into areas other than providing services directly to their owners, the phenomenon should be confined to smaller institutions.

Savings and Loan Holding Companies

One important question that is closely related to the subject of this paper should be mentioned. The powers of savings and loan holding companies that own only one S&L, and of savings and loan service corporations as well, are broader than those of bank holding companies and commercial bank service corporations. An analysis of the attendant problems and possible solutions to them lies beyond the scope of this paper. As time passes, however, these differences are likely to cause increasingly severe problems of competitive imbalance. They should be eliminated as part of an overall program of bringing government policies toward thrift institutions and those toward banks into line with one another.

Underwriting Activities

The Administration's proposal, S. 1609, would require that bank holding companies be permitted to underwrite revenue bonds of state and local governments. This activity, of course, is now off limits for both member banks and bank holding companies.

Because the distinction between general obligation bonds and revenue bonds that underlies the current statute is obsolete, banks should be permitted to acquire both types of obligations for their investment portfolios, as long as they are of sufficiently high quality.

Under S. 1609, however, if revenue bond underwriting were undertaken, then all underwriting of municipals would have to be transferred to bank holding company subsidiaries. A stated purpose of the Administration proposal is to prevent banks from funding their underwriting activities "unfairly," i.e., through banking subsidiaries. The writers have not investigated this point, but would point out that no convincing evidence has been developed to show that banks currently enjoy an unfair advantage in underwriting municipal general obligations. In the absence of such evidence, there seems to be no reason to worry about "unfairness" in the underwriting of revenue bonds.

VI. Conclusion

Changes in the provision of financial services are so rapid and profound that bank regulation, and the statutes that underlie it, must be brought up to date. On this proposition there is wide agreement.

The disagreement relates to strategies. Although bank regulators have considerable tools at their disposal to enforce separateness, including Section 23A of the Federal Reserve Act, restrictions on payments of dividends and solvency ratio tests, they have employed this approach only in a limited way, and with reluctance.

The view presented here is that regulation should be streamlined so as to focus on the essential core of banking services, without denying banking organizations the opportunity to expand their product lines in step with new technology and changing customer needs, and, just as importantly, without denying nonbanking organizations in the business of providing financial services the opportunity to acquire banks, to be operated in accordance with all of the regulations and supervisory policies that apply to banks. The suggested vehicle for this approach is employment of the principle of corporate separateness.

The debate over these alternatives will not be settled by this paper. The contrasts between the two viewpoints might be clarified, however, by two relevant quotations. The first is from an essay in the 1982 Annual Report of the Federal Reserve Bank of Minneapolis, written by E. Gerald Corrigan, President of the Reserve Bank. After noting there there are advantages to be gained from placing some activities in nonbank subsidiaries, he writes:

> "...such organizational arrangements are not likely to produce a situation in which the bank is immune from the problems, risks, or losses that might develop in such subsidiaries. In short, the holding company structure is neither a substitute for prudent management nor a fail-safe device for containing risk.32/

The second quotation relates to the use of separateness in the field of insurance regulation. It is taken from a story in the Wall Street Journal for March 28, 1983, concerning one aspect of the unfolding Baldwin-United saga:

> Standard & Poor's Corp. lowered its ratings on the outstanding debt of Baldwin-United Corp. and two of its units, D.H. Baldwin Co. and MGIC Investment Corp....

> S&P also affirmed the existing claims-paying ratings of ...[subsidiary]...units: American Municipal Bond Assurance Corp. at triple-A and Mortgage Guarantee Insurance Corp. at double-A. S&P said the insurance operations of the units haven't "shown deterioration in operating performance, and are sufficiently isolated from the parent's financing difficulties by insurance regulations."

The facts seem to be that the financial affairs of the two subsidiaries of MGIC Investment Corporation are effectively insulated from those of Baldwin-United and other subsidiaries of that company. Nothing is fail-safe. The relevant question is "which system works best?"

Appendix A

The following pages summarize the main provisions of the Administration proposal, embodied in S. 1609 and H.R. 3537, (the "Financial Distribution Deregulation Act of 1983"). This bill would, among other things, broaden the permissible activities of bank holding companies in a manner that relies, to a degree, on the use of corporate separateness to insulate banks from risks borne by their nonbank affiliates. This summary was prepared by the staff of the American Bankers Association.

Administration Proposal, S. 1609, HR. 3537, to
Deregulate Depository Institution Products and Services
Compared to Prior Administration Bill, S. 2490, and Current Law

Issue	Current Law	Prior Administration Proposal (S.2490)	S. 1609, HR. 3537
Regulatoty procedure to enter into non-bank activity	File application with Federal Reserve which must be noticed in Federal Register with opportunity for hearing. Deemed approved if Board does not act in 91 days of submission of "complete record", this includes additional information if requested, close of public comment period, hearing if ordered and recommendations of hearing officer.	Certain activities on 60 day prior written notice to Federal Reserve that may be extended 30 days. Federal Reserve may disapprove. Certain other activities require no notice.	60 day prior written notice which the Board may disapprove or suspend time period by order if more information needed. When furnished, activity may begin in 30 days if not disapproved.
Statutory test	Activity must be so "closely related to banking or managing or controlling banks as to be a proper incident thereto."	Activity must be of a "financial nature" identified by Federal Reserve in regulations.	In addition to "closely related" and "financial nature" tests may be one of the new activities set out below.
Criteria to be considered in approval or disapproval	To approve Federal Reserve must consider whether it is closely related to banking and whether activity can reasonably be expected to produce public benefits that outweigh possible adverse effects such as: 1) Concentration of resources 2) Decreased or unfair competition 3) Conflicts of interest 4) Unsound banking practices	To disapprove Federal Reserve must find activity is not on defined list or it has received insufficient or inaccurate information.	To disapprove Federal Reserve may consider: 1) Managerial resources 2) Financial resources 3) Independence of credit decisions 4) Safety and soundness

Issue	Current Law	Prior Administration Proposal (S.2490)	S. 1609, HR. 3537
Lines of non-bank business	1. Closely related to banking as determined by Federal Reserve under Sec. 4(c)(8) 2. Export trading companies 3. Other miscellaneous nonbank shareholdings allowed under Sec. 4	In addition to activities permitted under current law 1. Activities of a financial nature defined by Fed that must include most 4(c)(8) activities. 2. Insurance underwriting and brokerage. 3. Real estate investment, development and brokerage. 4. Underwriting state and local revenue bonds. 5. Mutual fund services. Allows the enumerated activities to be undertaken without notification to Fed.	All activities permitted under current law and S. 2490 but with all subject to prenotice procedure including "closely related." Real estate development and investment subsidiary subject to 5% of capital limit on investment. Added to list of businesses: 1. S&Ls 2. All permitted activities for multi-S&L holding company on 1/1/83. Fed may prescribe limits on any activity.
Supervision	Reports - Board may require reports from holding companies and subsidiaries to keep it informed as to whether the Bank Holding Company Act and its orders and regulation thereunder have been compiled with.	Reports - Board may require reports from holding company to keep informed whether holding company has compiled with BHCA and its orders and regulations thereunder. Board may require separate reports from subsidiaries registered as broker/dealer, transfer agents, or municipal securities dealers consisting of the same information they filed with the SEC and at the same time. For all other subsidiaries it may require reports, not more often than quarterly, consisting of the same information required by the SEC from publicly owned companies.	Reports - Board may require reports from holding companies and subsidiaries. Except where it requires less, or in particular circumstances where it requires more, it shall receive from nonbank subsidiaries the separate reports it was allowed to require in S. 2490.

Issue	Current Law	Prior Administration Proposal (S.2490)	S. 1609, HR. 3537
Lines of non-bank business	1. Closely related to banking as determined by Federal Reserve under Sec. 4(c)(8) 2. Export trading companies 3. Other miscellaneous non-bank shareholdings allowed under Sec. 4	In addition to activities permitted under current law 1. Activities of a financial nature defined by Fed that must include most 4(c)(8) activities. 2. Insurance underwriting and brokerage. 3. Real estate investment, development and brokerage. 4. Underwriting state and local revenue bonds. 5. Mutual fund services. Allows the enumerated activities to be undertaken without notification to Fed.	All activities permitted under current law and S. 2490 but with all subject to pre-notice procedure including "closely related." Real estate development and investment subsidiary subject to 5% of capital limit on investment. Added to list of businesses: 1. S&Ls 2. All permitted activities for multi-S&L holding company on 1/1/83. Fed may prescribe limits on any activity.
Supervision	Reports - Board may require reports from holding companies and subsidiaries to keep it informed as to whether the Bank Holding Company Act and its orders and regulation thereunder have been compiled with.	Reports - Board may require reports from holding company to keep informed whether holding company has compiled with BHCA and its orders and regulations thereunder. Board may require separate reports from subsidiaries registered as broker/dealer, transfer agents, or municipal securities dealers consisting of the same information they filed with the SEC and at the same time. For all other subsidiaries it may require reports, not more often than quarterly, consisting of the same information required by the SEC from publicly owned companies.	Reports - Board may require reports from holding companies and subsidiaries. Except where it requires less, or in particular circumstances where it requires more, it shall receive from non-bank subsidiaries the separate reports it was allowed to require in S. 2490.

Issue	Current Law	Prior Administration Proposal (S. 2490)	S. 1609, HR. 3537
Supervision continued	Examination - Board may examine holding company and all subsidiaries thereof.	Examination - Board may examine holding company and all subsidiaries provided the examination of non-bank subsidiaries shall be limited to their operations affecting the affairs of any bank subsidiary. However, if Board makes a finding that the financial condition of a subsidiary is likely to have materially adverse effect on the safety and soundness of a bank subsidiary the examination and reporting requirements are not so limited.	Examination - Board may examine holding company and all subsidiaries. However, it is to minimize scope and frequency for non-bank subsidiaries by using reports of applicable regulatory agencies or other public or private bodies and by focusing examination on activities or financial condition that may have a materially adverse effect on soundness of bank subsidiary.
	Cease and Desist and removal of directors or officers. These provisions of FDIC Act apply to non-bank subsidiaries of bank holding companies.	Cease and Desist and removal of directors or officers. These provisions of FDIC Act apply to non-bank subsidiaries of bank holding companies only to extent subsidiary engages in any action which may affect the safety and soundness of any bank subsidiary or otherwise violate banking law, regulation or order.	Cease and Desist and removal of directors or officers. Same as current law.
Securities - Types of activities in which banking may engage	1. Underwrite U.S. obligations. 2. Underwrite general obligations of state and local governments. 3. Underwrite a few enumerated state and local revenue bonds. 4. Buy and sell securities on customer order including public discount brokerage service. 5. Organize, sponsor, operate & control closed-end mutual fund.	In addition to activities listed under current law: 1. Underwrite all state and local revenue bonds except industrial development bonds. 2. Organize, sponsor, operate and control open end mutual fund. 3. Sell all mutual fund shares	Same as S. 2490 except could underwrite IDBs if: 1. a governmental unit pledges full faith and credit, or 2. the state or local government is considered sole owner of financed facility for Federal income tax purposes.

Issues	Current Law	Prior Administration Proposal (S. 2490)	S. 1609, HR. 3537
Securities - Which activities may be conducted in bank	All of the above with the possible exception of organize, sponsor, operate and control closed-end mutual funds. That has been determined proper for a bank holding company.	All the new activities above must be done in a separate subsidiary and if any of the new activities are undertaken then all current securities activities conducted in an affiliated bank must be transferred within one year to the separate subsidiary.	Same as S. 2490.
Securities - Subsidiary	No requirement	If a bank has less than $100 million in assets and it is not in a holding company, the separate subsidiary may be a subsidiary of the bank. Otherwise the separate subsidiary must be a holding company subsidiary	Small bank exception dropped must be holding company subsidiary.
Real estate investment development and brokerage	National banks not allowed. State banks up to state. Bank holding companies not allowed.	Would allow a bank holding company to acquire a subsidiary conducting such business.	Same as S. 2490 except holding company could only invest up to 5% of primary capital in a real estate investment or development company.
Insurance underwriting and brokerage	National banks limited brokerage activity. State banks up to state. Bank holding companies limited brokerage and underwriting activity.	Would allow a bank holding company to acquire a subsidiary conducting such business.	Same as S. 2490.

Issues	Current Law	Prior Administration Proposal (S. 2490)	S. 1609, HR. 3537
Bank Service Corporation	1. State bank owned BSC can perform any service that the state bank can. 2. National bank owned BSC can perform any service that the National bank can. 3. State and National bank owned BSC can perform any service both can. 4. Any BSC can perform any service, other than deposit taking, that the Fed has by regulation found permissable for bank holding company, 4(c)(8),Reg. Y. 5. Prior approval to invest in BSC must be obtained from appropriate regulatory agency except that the activities under 4 require Fed approval.	No provision	a. Repeals most BSC powers granted by Garn-St Germain Act. b. BSC may be owned by one bank but are limited to providing services to depository institutions and credit unions such as: 1. Check and deposit sorting and posting. 2. Preparation and mailing of checks, statements, etc. 3. Appraising and abstracting. 4. Bookkeeping and accounting. c. Stock S&Ls are limited to same service corporation as banks. d. All current service corporations grandfathered. e. Mutual S&Ls may continue to use service corporation as under current law for activities approved before 7/1/83.
Definition of "bank" for BHCA purposes	Institution that takes demand deposits and makes commercial loans.	No provision	1. An insured bank, institution eligible to become an insured bank or institution that accepts demand deposits and makes commercial loans. Does not include foreign bank with insured branch, S&L, Edge Act Corporation or agreement coporation. 2. All non-bank banks acquired prior to 7/1/83 would be grandfathered with certain provisions for losing grandfather rights.

Issue	Current Law	Prior Administration Proposal (S. 2490)	S. 1609, HR. 3537
Small banks	No provision	Were allowed to use subsidiary of banks for securities activities if bank not in holding company and under $100,000,000 in assets.	1. Reorganizations into holding company with virtually same shareholders and same proportional share interests exempted from registration under the 1933 Securities Act. 2. 30 day pre-notice procedure under Bank Holding Company Act. Subject to following additional criteria: a. must meet capital and other financial standards prescribed by Fed by regulation b. immediately following re-organization not engaged in any activity other than banking. Board cannot require more capital for subsidiary bank than is required for similar size bank not subsidiary of holding company.
S&L holding companies	Their own unrelated laws	No provision	Basically similar treatment by statute but FHLBB makes rules and supervises.
Right to sue under Anti-tying provisions of BHCA and HOLA	No provision	No provision	Trade associations permitted to commence on behalf of any of their members, a private right of action for injunctive relief.

Appendix B

This appendix presents the economic reasoning behind the proposition, made in the Introduction to this paper, that active employment of the strategy of "corporate separateness" in the regulation of bank holding companies can permit banking organizations to expand the scope of their activities without drawing them into the net of prudential oversight. The discussion centers on the operation of "market discipline," and uses as its framework the approach to the theory of corporate finance.

This theory teaches that, no matter how they structure their balance sheets, business enterprises are not allowed to escape the ramifications of risk imposed on any classes of investors. One might well say that for corporations generally the most important financial regulators are the private markets for securities and loans.

The Modigliani-Miller theorem (see footnote 1) is especially helpful in explaining the problems posed by regulatory intervention. In its simplest form, this theorem might be stated as follows:

> The market value of the claims on a corporation's assets, including all liabilities and all equity shares, is independent of the composition of those claims.

This simplified statement (which ignores, among other things, intervening government forces such as loan guarantees and taxes) implies that there is nothing to be gained from leveraging, i.e., borrowing to finance asset holdings.

Without intending to reopen the numerous arguments that surround the Modigliani-Miller theorem, we would suggest that the principal reasons for it not to hold fall into one or more of the following classes:

1. government intervention, including taxes, regulation, and debt guarantees or other forms of support;
2. dishonesty on the part of issuers of debt that is not perceived by investors;
3. imperfect knowledge on the part of investors, which may be closely related to (2) above;
4. lack of competition in markets for some claims.

All of the above sources of "noise" are present, to one degree or another, in business finance. Commercial banking, however, along with other types of deposit intermediation, has evoked a special class of governmental intervention at both the Federal and state levels.

The most important objective of government policy is to make deposit liabilities riskless, or nearly so. The objective is pursued through a multitude of state and Federal banking laws, regulations, insurance systems and programs of supervision. Thus, while a buyer of debt obligations issued by, say, Household Finance is supposed to look out for his own interests, a "buyer" of bank deposits need not worry about the safety of his principal, unless the amount exceeds the statutory $100,000 maximum. For deposits over $100,000 and for subordinated debt as well, most investors still feel protected by various government devices including the Fed's discount window and the knowledge that banks are routinely examined for "soundness."

It is precisely the faith of depositors that makes banks such attractive funding vehicles and, among other things, gives rise to fears that innovative moves by banks represent "unfair competition." In terms of the simplified Modigliani-Miller model, the government's explicit and implicit guarantees tend to raise the market value (or lower the interest costs) of the liabilities of banking institutions. The effect is especially great for the deposit liability portion of the balance sheet, and most particularly for insured deposits.

Put another way, to the extent that depositors and other creditors feel they can rely on government, they do not feel the need to do their own "policing." As would be expected, there results a need for additional government supervisory and regulatory intrusions.

Use of the strategy of corporate separateness can obviate much of this need. This would permit bank supervisors to concentrate on their legitimate role -- the protection of the soundness of banks -- at the same time it maximized the room for organizations that owned banks to carry on their other business regulated either by market forces or, where appropriate, government agencies other than bank regulators.

Footnotes

1. Modigliani, F., and Miller, M., "The Cost of Capital, Corporation Finance, and the Theory of Investment," *American Economic Review*, June 1958, pp. 261-297.

2. Henn, H. *Law of Corporations*, §252 at 501 (2nd Ed. 1970); Fletcher, *Cyclopedia of Corporations*, §25 at 100 (rev. vol. 1974).

3. Lattin, *Law of Corporations* §24 at 100 (2nd Ed. 1971); *Kulukandis v. Dean Stores Holding Co.*, 132 Conn. 685 47 A2d 183, 184 (1946); *Berkey v. Third Ave. R. Co.*, 244 N.Y. 84, 155 NE 58 (1926).

4. Kulukundis infra note 2; *Martin v. Development Corp. of America*, 240 F 42, 45 (9th Cir. Ariz. 1917).

5. E.g., *Ledlow v. Goodyear Tire and Rubber Co.*, 238 Ala. 35, 189 So. 78, 80 (1939); *Miller v. Robertson*, 266 U.S. 243, 69 L. Ed. 265 (1924).

6. *Glenhill v. Fisher & Co.*, 272 Mich. 353, 262 NW 371, 373 (1935).

7. Krendl and Krendl, "Piercing the Corporate Veil: Focusing the Inquiry," 55 *Denver L.J.* 1, 2 (1978).

8. Note, "Liability of a Corporation For Acts of a Subsidiary or Affiliate," 71 *Harvard L. Rev.* 1122, 1123 (1958).

9. Id.

10. Comment, "Corporate Fiduciary Doctrine in the Context of Parent-Subsidiary Relations," 74 *Yale L.J.* 338 (1964).

11. Note, supra at 1123.

12. Henn supra, §147 at 256-59.

13. Douglas and Shanks, "Insulation From Liability Through Subsidiary Corporations," 39 *Yale L.J.* 193 at 206 (1929).

14. See e.g., Ohio General Code 1940, §710-75, repealed see Ohio Rev. Code §1105.19.1 to 1105.30; Ky. Rev. Stat. Ann. 1942, §287.360. See also *Mitchie on Banks and Banking*, Vol. 2 Ch. 5 § 22 et. seq. An extensive discussion of double liability is contained in the earlier editions in Vol. 7 Ch. 15 §72 et. seq.

15. Congress terminated double liability on national banks in stages. In the Banking Act of 1933 Congress ended the liability on shares issued after June 16, 1933 (June 16, 1933, c.89 §22, 48 Stat. 189). In 1935, double liability on all shares was ended effective July 1, 1937, provided that the bank publish a notice of this termination six months before its effective date (Aug. 23, 1935, c.614 §304, 49 Stat. 708). In 1953, Congress effectively ended double liability for all banks (May 18, 1953, c.59 §2, 67 Stat. 27) and totally repealed the statute in 1959 (73 Stat. 457).

16. 306 F2d. 937 (9th Cir. Mont. 1962).

17. 379 U.S. 411 (1965).

18. This section draws heavily on Chase, S., "The Bank Holding Company - A Superior Device for Expanding Activities?," in Policies for a More Competitive Financial System, Conference Series No. 8, Federal Reserve Bank of Boston, 1972, pp. 77-78.

19. "The Future of American Express," Fortune, April 1964, pp. 158-159 and 254-260. Quote from p. 260.

20. "Raytheon and the Mayor of Palermo," The Economist, June 22, 1968, pp. 69-79. Quote from p. 70.

21. 12 U.S.C.A. §56, §59, §60.

22. 12 U.S.C.A. §324.

23. Board of Governors of the Federal Reserve System, Division of Banking Supervision and Regulation. SR 82-17, March 17, 1982.

24. McKinney's Consolidated Laws of New York Annotated, Insurance Article IV-A-Holding Companies.

25. New York Insurance Law, §69-g.

26. Id. at §46-a(5).

27. Id. at §69-e.

28. See, e.g., Ann. Code of Maryland, Art. 48A, §500.

29. New York Insurance Law, §46-a, §85-a(4), §97.

30. Id. §97.

31. Rhoades, S.A. and Boczar, G.E., "The Performance of Bank Holding Company-Affiliated Finance Companies," Board of Governors of the Federal Reserve System Staff Economic Studies (1977); Rhoades, S.A., "The Performance of Bank Holding Companies in Equipment Leasing," The Journal of Commercial Bank Lending, Oct., 1980, pp. 53-61; and Talley, S.H., "Bank Holding Company Performance in Consumer Finance and Mortgage Banking," The Magazine of Bank Administration, July 1976, pp. 42-44.

32. p. 18.

Attachment 2

Checks and the Delayed Availability of Deposited Funds

A check is nothing more than a written order to pay from the owner of an account to the bank where the account is located. The check tells the bank who to pay (the payee) and how much. The signature verifies that the account holder has, in fact, authorized the transfer. In order for the payee to convert the check into hard currency, he needs to take the check to the bank holding the account on which the check is drawn. However, most people when they get a check, rather than go across town, (or across the country) to present the check for payment, take the check instead to their local bank and deposit it (the bank of first deposit). Their local bank takes on the job of getting the check to the bank which holds the account (the payor bank). The process by which the check is moved to the payor bank for collection is a very sophisticated and high speed process.

The check collection system moves about 100 million (100,000,000) checks every day. The system is very efficient in moving checks from the bank of first deposit to the payor bank. This is chiefly because the system is almost totally automated, and typically, after initial processing, a check moves virtually untouched by human hands to the payor institution. Each check has encoded on it in magnetic ink, identification numbers for the payor bank and the particular account at the bank on which it is drawn. (See attached exhibit). The processing equipment in each successive institution that processes the check reads this data and sorts the checks into bundles for shipment to the next processing institution. The bundles of checks are moved from one institution to the next along the collection chain by couriers.

This system works so well that a recent Federal Reserve Bank study estimated that 98 percent of all checks reach the payor institution within three days of deposit, despite the fact that the check may have passed through a network of several commercial and Federal Reserve banks on the way. Once the check reaches the payor bank, it is up to that institution to examine the check to determine its validity and whether there are sufficient funds in the account. The reason for bank hold policies that substantially exceed the forward processing time, is that there could be a problem with the check or the account balance. If the payor bank decides not to pay the check, under current procedures the check is returned to the bank of first deposit through the same chain of banks which processed it on the forward route. Unfortunately, the check processing system that operates under current procedures and legal constraints is not nearly as efficient going backwards as it is going forward.

The Midnight Deadline and Provisional Credit - A Pair That Could Leave A Bank With A Full House of Bad Checks.

The attached illustration explains the number of institutions that may actually process a check before it reaches the payor bank. As the check moves on its forward path, each institution gives the prior institution provisional credit for the item. For example, when the bank of first deposit sends the check to its correspondent, the correspondent will give the first depository bank a credit in a special account which the first depository bank maintains with the correspondent. The credit, however, is provisional and subject to cancellation if the payor bank ultimately dishonors the check. This provisional crediting continues along each step of the way until the check reaches the payor bank. Under the Uniform Commercial Code, the law which governs check collections, the payor bank having given provisional credit for the item, has until midnight of the next business day to dishonor the item and revoke the provisional credit. If it does nothing, the credit is made final and all of the provisional credits in the chain are final. In short, the bank is stuck with the check.

The transportation and processing of checks operates on a 24 hour cycle. The evening hours are the logical time to collect and distribute the checks generated during the business day. During this time period, the checks are physically moved among Federal Reserve Districts and among banks within the districts. A correspondent bank* may receive checks drawn on a number of its respondent banks or other banks in addition to checks drawn on it. (A check drawn on a bank is called an "on-us" item by that bank because from the bank's perspective, it is drawn "on-us". Conversely, if the check is drawn on another bank and the correspondent is merely processing it, it is a non-on-us item). The initial sort by the correspondent separates the checks going elsewhere from the "on-us" checks.

In the morning, the "on-us" checks are received from the Federal Reserve and/or local clearing house and are processed along with the growing flow of items received through that banking day from the various offices of the bank (i.e., consumer and merchant deposits; cashed checks, etc.). By evening, the cycle is beginning again. The "non-on-us" items received during the day are transported during the evening. Meanwhile, computers are posting the accounts with the information from the morning and afternoon processing. It is not until the following morning that the checks drawn on accounts with insufficient funds are identified. If there are insufficient funds in the account, the bank may wait before dishonoring the check in anticipation of a deposit sometime that day. Therefore, the final decision to dishonor a check many times does not occur until the early evening. The bank must then quickly get the check on its way back to the previous bank to avoid the impact of the midnight deadline. Usually, the only way to get the check out of the bank's control and on its return journey (and thus, avoid the midnight deadline), is to put the check into the mail on its way back to the next prior endorser. As long as the check is in the mail before midnight, it is legally deemed to be "sent", and the dispatching institution is absolved of responsibility for it.

The impact of the Postal Service on the return process should be self-explanatory. In addition, the actual check processing of returns is all done manually. On the forward path, each processing bank places its endorsement on the back of the check. On the reverse path, each bank must examine the back of each check to make sure it was an endorsing bank. It must then determine the next prior endorser, adjust its books to remove the provisional credit previously given, and send it on its way. This process can easily take three or four times longer than the forward processing trip.

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* See attached illustration.

The costs associated with developing the technology for the rapid forward processing of checks could easily be justified by the tremendous volumes processed. However, the relatively miniscule return volume does not provide the same jusitification for developing a new technology to automate returns.

Under the current system, the bank of first deposit never knows for certain if a check is good. The immense volume of checks processed each day and the vast number of institutions involved in the payments system (around 40,000) make it impossible to give positive notice that each check has been paid. The bank of first deposit can only assume that a check was good if enough time passes for the check to get to the payor bank and be returned, without the check actually being returned. The key then to reducing hold periods is to expedite the return process, a project which the Federal Reserve Board is engaged in at the current time known as "The Dallas Project".

The Dallas Project

The two major problems with the current return process are that (1) it is a manual process, each check must be individually examined at each institution along the return processing chain, and (2) the high speed courier system that moves checks forward through the system is virtually useless in the return process due to the midnight deadline and the length of time it takes to manually process returns.

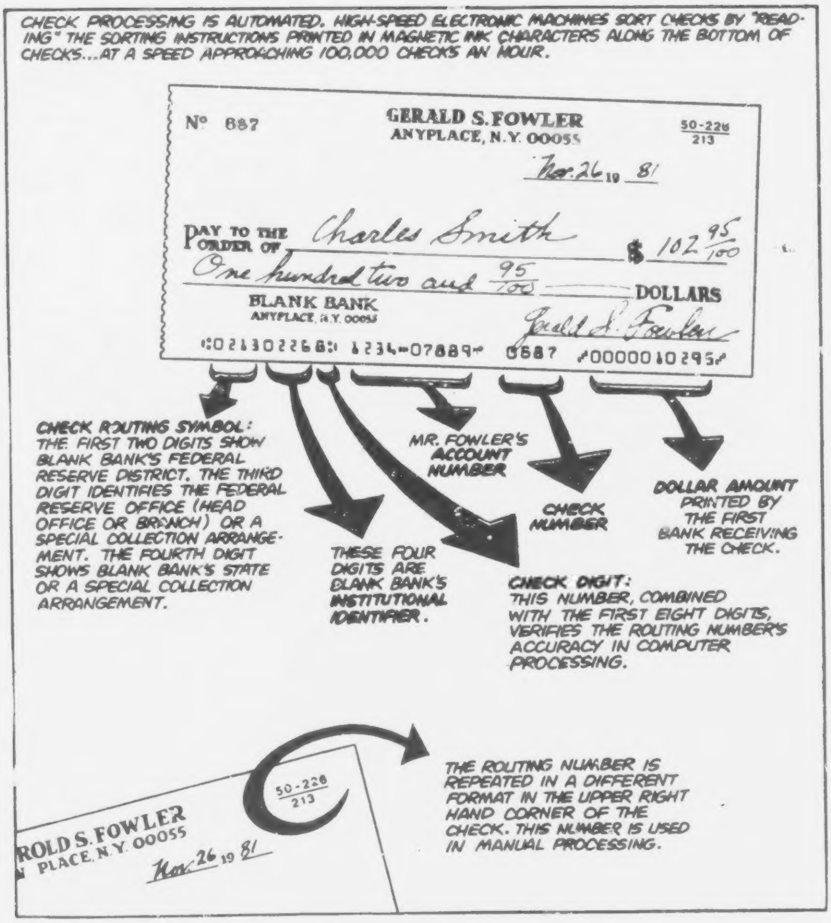
Recognizing the need for change, the Transaction Processing Committee of the American Bankers Association's Operations and Automation Division examined the issue and came up with a suggestion that has resulted in the experimental return system currently being tested in Dallas.

Under this system, the dishonoring payor institution would place the dishonored check in an envelope and encode the envelope in magnetic ink with the institutional identifier of the bank of first deposit and the dollar amount of the check.

Once this is done, the check can be processed back to the institution of first deposit via the existing automated process. In short, the "return item" becomes, as far as the automated processing system is concerned, a forward moving check bound for the institution of first deposit. This system would also result in the by-passing, on the reverse trip, of some of the intermediary banks currently involved in the process. The implementation of such a system on a nationwide basis could substantially reduce the time it takes for a check to make its way back to the bank of first deposit. Implementation would be greatly facilitated since it uses existing technology and equipment.

The initial results of the Dallas test appear to be very encouraging, and the Association is committed to assisting the Fed in pursuing accelerated implementation of this inovative new return system as soon as possible.

CHECK PROCESSING IS AUTOMATED. HIGH-SPEED ELECTRONIC MACHINES SORT CHECKS BY "READING" THE SORTING INSTRUCTIONS PRINTED IN MAGNETIC INK CHARACTERS ALONG THE BOTTOM OF CHECKS...AT A SPEED APPROACHING 100,000 CHECKS AN HOUR.


N° 687
GERALD S. FOWLER
ANYPLACE, N.Y. 00055
50-226/213
Nov. 26 19 81
PAY TO THE ORDER OF Charles Smith
$ 102 95/100
One hundred two and 95/100 DOLLARS
BLANK BANK
ANYPLACE, N.Y. 00055
Gerald S. Fowler
⑆021302268⑆ 1234-07889⑈ 0687 ⑈0000010295⑈
ROLD S. FOWLER
PLACE, N.Y. 00055
50-226/213
Nov. 26 19 81

CHECK ROUTING SYMBOL: THE FIRST TWO DIGITS SHOW BLANK BANK'S FEDERAL RESERVE DISTRICT. THE THIRD DIGIT IDENTIFIES THE FEDERAL RESERVE OFFICE (HEAD OFFICE OR BRANCH) OR A SPECIAL COLLECTION ARRANGEMENT. THE FOURTH DIGIT SHOWS BLANK BANK'S STATE OR A SPECIAL COLLECTION ARRANGEMENT.

THESE FOUR DIGITS ARE BLANK BANK'S INSTITUTIONAL IDENTIFIER.

MR. FOWLER'S ACCOUNT NUMBER

CHECK NUMBER

DOLLAR AMOUNT PRINTED BY THE FIRST BANK RECEIVING THE CHECK.

CHECK DIGIT: THIS NUMBER, COMBINED WITH THE FIRST EIGHT DIGITS, VERIFIES THE ROUTING NUMBER'S ACCURACY IN COMPUTER PROCESSING.

THE ROUTING NUMBER IS REPEATED IN A DIFFERENT FORMAT IN THE UPPER RIGHT HAND CORNER OF THE CHECK. THIS NUMBER IS USED IN MANUAL PROCESSING.

Illustration of Check Processing System

Preface

For this example, let's follow a hypothetical check drawn on a bank in Connecticut and deposited in a District of Columbia bank. A check moving from the District to Connecticut for collection would pass through many more hands than an intra-state or local check, but will be illustrative of the way the check clearing system operates. The first step is the payee endorses and deposits the Connecticut check in the D.C. Bank.

Local D.C. Bank

The D.C. Bank will accept the check for deposit and provisionally credit the payee's account for the amount of the check. The bank will then encode the check with the dollar amount in magnetic ink on the lower right hand corner and forward it directly to the Federal Reserve Bank of Baltimore or to a correspondent bank, depending on the size of the bank of first deposit.

Local Correspondent Bank

Many smaller banks have relationships with larger regional banks to provide them with check clearing and other services. These so-called correspondent banks may service many such smaller banks. The Correspondent uses its high speed processing equipment to sort the checks it receives into bundles bound for other banks and the local Federal Reserve Bank. The Connecticut bound check would probably end up in the bundle going to the Baltimore Federal Reserve.

The Baltimore Federal Reserve Bank

The Federal Reserve System operates a very sophisticated air and land courier system for many checks between Federal Reserve Districts and between banks within a Federal Reserve District. Since Connecticut is in the 1st Federal Reserve District and is serviced by the Boston Federal Reserve Bank, the Baltimore Fed would bundle the Connecticut check with all the other checks it has received from area banks which are bound for the 1st Federal Reserve District, and send them on to Boston.

Boston Federal Reserve Bank

The Boston Federal Reserve Bank will sort the checks it receives from the Baltimore Fed and bundle them to go out to the various banks in the 1st District. The Connecticut check may go directly to the Connecticut payor bank, or it may go to a correspondent of the Connecticut Bank.

Connecticut Payor Bank

Once in its hands, the payor bank must make a decision to pay or not to pay. In the event that the item is not paid, it must be "sent" back to the next prior endorser by midnight of the next business day.

Attachment 3

AMERICAN
BANKERS
ASSOCIATION

1120 Connecticut Avenue, N.W.
Washington, D.C.
20036

PRESIDENT
William H. Kennedy, Jr.
Chairman of the Board
National Bank of Commerce
P. O. Box 6208
Pine Bluff, Arkansas 71611

August 2, 1983

Dear Fellow Banker:

Recently, heightened Congressional and regulatory concern over delayed availability of consumer funds has built serious pressure for legislation to force disclosures of funds availability policies and/or require that funds be made uniformly available within a rigid time frame. These pressures are at work at both the state and federal levels.

An ABA banker task force considering this threat has suggested that certain voluntary actions by bankers could relieve much of this public and political concern. Specifically, the bankers on the task force have suggested that adoption of a bank policy statement on funds availability and use of a consumer disclosure statement could remove much of the confusion which is causing customer misunderstandings.

We believe strongly that no uniform, nationwide policy could be made to work. However, if each bank made clear its own necessary policies in statements to its customers and employees, the suspicions surrounding the matter of funds availability could be cleared away to a large extent.

Attached are a sample policy statement and sample customer disclosure statement which might be of help to you as you consider this matter.

If you have any questions about these suggestions or the use of these samples, please feel free to write me in care of the American Bankers Association.

Sincerely,

William H. Kennedy Jr.

William H. Kennedy, Jr.
President
American Bankers Association

Sample Policy Statement

Holds on Retail Customer Accounts

It is ____(name of bank)______'s policy to place holds on customer accounts to reduce the risk of check kites and of checks returned for insufficient funds or any other reason to customer accounts in which the balance is insufficient to cover the returned item.

Generally, holds will be placed on checks deposited from sources not known to the bank in newly opened retail customer accounts. A new account is considered to be one that has been open for no more than (period of time - e.g., one month, six months or other). In addition, unusually large items deposited to an account, such as those over __(dollar value, e.g., $500)_ may also have a hold placed on them.

The length of a hold will reflect the bank's normal experience in dealing with checks returned from the location on which the deposited item was drawn. Normally, the hold will not exceed ____ days from any location within the United States.

Customers will be informed at the time an account is opened of this bank's hold policy. (Include the following if applicable) And tellers will inform customers at the time a deposit is made on which a hold is placed of the applicability and duration of the hold. (Branch managers, personal banking officers, or other title), upon customer request, have the authority to release holds on items, in their discretion, when a customer is known to them, the drawer of the check is reliable, or other circumstances exist to justify releasing a hold. It is the policy of this bank to minimize the use of holds to the extent consistent with the safety and soundness of the bank and the avoidance of unnecessary losses to the bank.

Sample Disclosure Statement

Holds on Deposited Checks

When you deposit a check drawn on another bank, there is always a time delay before the check reaches the bank on which it was drawn and we receive payment. Our policy is to provide the earliest realistic availability of funds on deposited items. But we must reserve the right to place a "hold" for the amount of the check you deposit until we have collected those funds.

Normally, we would place "holds" on a check you deposit if:

(Include only those that apply)

1. Your account is new, and it has not yet developed enough history of activity for us to know you;
2. You deposit a check for an unusually large amount;
3. Your check is drawn on another bank or financial institution;
4. You make a cash back or split deposit;
5. Your check is issued by a person or organization whose reliability is not known to us.

(Use the following if applicable)

When we must place a "hold" on your deposit, it may be necessary for us to ask you not to withdraw these "uncollected funds" from your account. When this occurs, your teller will inform you that a "hold" has been placed on your check, and the estimated time it will take for the check to be paid. Normally, holds will be for _____ business days on checks drawn on banks in (town, city, state) and for _____ business days on checks drawn from outside this area.

Of course, deposits into any interest-bearing account will begin to earn interest as soon as they are made whether a "hold" is placed on the deposit or not. We hope this policy will not inconvenience you, and encourage you to speak with one of our officers concerning any questions you may have about this policy.

The CHAIRMAN. Thank you, Mr. Olsen.
Mr. King.

STATEMENT OF A. JACK KING, PRESIDENT, VALLEY BANK, KALISPELL, MONT.; SECOND VICE PRESIDENT, INDEPENDENT BANKERS ASSOCIATION OF AMERICA

[The complete statement follows:]

Mr. Chairman and Members of the Committee, my name is Jack King and I am the Second Vice President of the Independent Bankers Association of America (IBAA). IBAA is the national trade association representing more than 7,000 independent community banks serving customers in forty-nine states and the District of Columbia. I am also President of the Valley Bank of Kalispell, Montana, a state-chartered institution founded in 1911 which today has $42 million in assets.

Last month, the IBAA Resolutions Committee met and considered the new bills submitted by Chairman Garn and Senator Proxmire. While our draft Resolution on Expanded Powers For BHCs must be reviewed and approved by our full Convention next month, I believe that it does provide the framework for our consideration of any products legislation in 1984. The Resolution states:

> The IBAA supports permitting bank holding companies to engage in securities, real estate, and insurance activities as proposed by the Administration in its "Financial Institutions Deregulation Act" (FIDA).
>
> Our support for any expanded powers legislation is contingent upon keeping the legislation clean of any provisions providing for the payment of interest on demand deposit accounts, or which explicitly change the Douglas Amendment or the McFadden Act. We continue to oppose the consumer bank concept embodied in the Garn draft bill and will weigh carefully the effects of any legislative proposal on financial concentration and on the safety and soundness of the banking system.

Let me elaborate. We believe that the new products and services must be made available to banks to allow us to increase fee income to help compensate for the substantial deregulation of our liabilities. Although many independent banks are not now organized as holding companies, the BHC subsidiary requirement is acceptable, provided that the legislation's provisions for expedited holding company formations are retained and, to some extent, improved.

However, the IBAA cannot support legislation opening these product and service doors if the price is removal of the prohibition on the payment of interest on demand deposit accounts. Most small banks will not utilize fully the new opportunities sanctioned by these proposals, but all will experience an immediate outflow of profitibility if market rates are paid to commercial checking customers. A survey of our membership last fall indicated that the payment of a super-NOW rate on existing commercial checking accounts would cut pretax profits by thirty to fifty percent. We may be just emerging from the greatest period of bank failures in fifty years. That is a cause for great concern, but not the only cause for concern. With $200 billion-plus Federal deficits stretching across the fiscal horizon, the future may well bring higher interest rates, renewed business difficulties and problem loans, and decreased loan demand. In such an environment, and with more and more of our liabilities indexed to market rates, banks and S&Ls will have to try to retain profitability largely by further boosting the cost of credit, and raising service fees. Consumers already have a broad spectrum of interest-bearing deposit products to choose from, and businesses with cash surpluses may invest in CDs, MMDAs, and other instruments. Putting interest on business transaction accounts will hurt the very entities it purports to help--the cash-short small business which must utilize credit. Putting it into effect at this time would be unsafe and unsound.

While absent from the Senate bills, we must note that Chairman St Germain has introduced legislation which adds to this proposal the repeal of the Garn/St Germain Act's requirement that thrifts' business checking accounts must be preceded by a credit relationship. If thrifts are extended universal checking powers, their already tenuous claim to a separate identity would be completely voided and the time would be at hand to place both banks and thrifts under a single tax and regulatory scheme.

Let us now turn to the misnomer of interstate banking. We all know that interstate banking is here. The real issue is interstate deposit-taking by corporations owning banks in more than one state. The IBAA believes that the Douglas Amendment to the BHCA, which delegates to each state its own decision on this issue, is essential to the prevention of excess economic concentration, the retention of a diverse group of local allocators of credit, and the survival of a dual banking system. In my own state, I have witnessed the export of tens of millions of dollars in local deposits by an interstate savings and loan company.

We are pleased to note that Senator Garn's legislation has amended the Treasury bill to subject BHC's interstate acquisitions of thrifts, which now have substantial commercial lending powers, to the Douglas Amendment. We are also pleased that the major banking trade associations feel that the essential product deregulation legislation pending before this Committee should not be encumbered by geographic deregulation. Geographic deregulation remains highly controversial within the banking industry and the interests of the money center banks are often at odds with the regional banks as well as the community banks.

Unfortunately, the Garn bill does contain provisions which carve out BHCA exceptions for industrial banks, consumer banks, and qualified thrift lenders. Authorizing such exceptions undercuts the whole thrust of the Treasury bill, which is to assure that all bank-owning organizations are subject to the same rules and regulations. Much of the debate in this area has focused on the consumer bank, which is the new label for the nonbank bank. However, analysis reveals that firms wishing to own depositories under better-than-fair rules would surely opt for the more potent industrial bank or qualified thrift lender. As proposed, a firm ineligible to be a BHC could nonetheless own insured industrial banks, in states which had never explicitly authorized interstate commercial bank ownership. And those banks could offer NOW accounts and engage in unrestricted commercial lending. Similarly, that firm could also own a qualified thrift lender with substantial commercial lending authority, and could cross-sell its products through their other businesses. And, as Chairman Volcker has pointed out, three-fourths of the Nation's banks could pass the qualified thrift lender test and opt out from under the BHCA.

The nonbank loophole must be closed, not legitimized. Companies which own nonbank banks following enactment of a products bill should be given two years to conform their activities to those of a BHC or divest their bank. As for unitary savings and loan holding companies, we support the tightening of their activities based upon mortgage investments, and separate and distinct business operations from the parent, as proposed by Senator Proxmire.

To repeat, the IBAA supports new products and services for banks, and new eligibility for other financial players to own banks, under the structure of the Bank Holding Company Act. We believe that such legislation is achievable now. But we do not support drastic weakening or repeal of the Act, and do not believe that legislation which proposes to do that can be enacted in this Congress, the next Congress, or at any time in the forseeable future. And, so long as we have such an Act, there will be restrictions on the ownership and location of banks which some firms will not like. But they must abide by the same laws as the rest of us.

In this connection, we continue our support for enactment of a legislative moratorium on cross-financial industry acquisitions. As you know, the Comptroller's non-moratorium moratorium, which specifically excludes such proposals as Dimension Financial Corporation's plan for a 25-state network of 31 banks, expires on March 31. The Comptroller has indicated that the moratorium will not be extended and rumors "in the street" suggest that the pending Dimension applications may be acted upon before then. This would be a most inappropriate preemption of the power of this Committee to help determine the future shape of the financial industry. While the Federal Reserve's recent revision of Regulation Y has done much to preserve Congressional intent under the BHCA, the nonbank loophole is still partly open and must be completely closed. However, we would much prefer to see this issue resolved in the context of comprehensive legislation promoting fair and effective competition between all financial providers, rather than deferred until another Congress.

Moving to the subject of regional interstate banking zones, a concept which the Garn bill proposes to validate, IBAA's position is that financial concentration and dilution of local control do not become more acceptable when they occur within regional bounds rather than on a nationwide basis. We therefore oppose proposals for regional banking zones. We do not see what broader public policy is served by encouraging regional banks to acquire other banks within their region. How will the consumer of bank services be better served by this? It is a prescription for fewer banks insulated from competition.

An attachment elaborates upon the issues I have discussed, as well as additional issues. Before concluding, let me briefly state IBAA's position on a number of those subjects--

--We support the concept of concentration limits as proposed by Senator Garn, but would like to see them further strengthened for cross-financial industry acquisitions, as well as made applicable to mergers between substantial BHCs.

--We oppose the repeal of those bank service corporation provisions enacted in the Garn/St Germain Act. Congress determined in 1982 that the powers then available to banks and BHCs could be exercised by a service corporation. Retention of this option is particularly crucial to the survival of those small banks which do not choose to utilize the new products and services under discussion today.

--We support the payment of interest on reserves, but note that it will provide little in the way of compensation to smaller banks. Further, we believe that reserve requirements should be extended to all transaction products, regardless of whether they are offered by a depository institution.

--We are now surveying our members in regard to check holding policies. Our initial impression is that abuses in this area have been exagerated, and are primarily found in larger metropolitan institutions. We do not support new regulatory burdens in this area.

--Bankers' banks technical amendments should be adopted in 1984, as they merely clarify existing legislation and are in no way controversial. We appreciate the previous expressions of support received from Senators Garn, Proxmire, and others when these provisions were inexplicably stripped from the Garn/St Germain technical amendments bill.

That concludes my oral remarks. I would be pleased to answer your questions, and ask that my complete statement be made part of the hearing record.

# # # #

ATTACHMENT

POSITION OF THE
INDEPENDENT BANKERS ASSOCIATION OF AMERICA

Regarding Issues Raised By
S. 1609, S. 2134 & S. 2181

Expanded Powers for Bank Holding Companies

The IBAA supports permitting bank holding companies to engage in new securities, real estate, and insurance activities as is proposed in S. 1609. In addition to those powers, we are also in support of authorizing depository institutions to underwrite mortgage-backed securities as proposed in S. 2181. We support the Treasury bill's provisions relating to the designation of permissable activities by the Federal Reserve Board, as well as related provisions concerning approval, regulation, examination, and reporting requirements.

Expedited Procedures for One Bank Holding Company Formations

Special, expedited procedures for the formation of one bank holding companies are essential for independent community banks to take best advantage of these new product and service activities. Therefore, we support the provisions relevant to such formations contained in all three bills. Further, the legislation should also be amended to make clear that any BHC with assets of no more than $250 million should be regarded as adequately capitalized if the underlying bank would satisfy its capital requirements as a freestanding entity, to eliminate impediments to such formations raised by certain consolidated capital rules of regulatory agencies. Also, the legislation should be amended to explicitly state that SEC registration requirements are waived for any BHC formed under these expedited procedures, regardless of the number of its shareholders.

Cross-Industry Acquisitions Between Banks and Thrifts

The IBAA opposes permitting BHCs to acquire thrifts, or thrifts to acquire banks, other than through the tiered bidding process for failing institutions contained in the extraordinary acquisitions sections of the Garn/St Germain Act.

Concentration Limits

The IBAA supports the concept of concentration limits on the merger of bank holding companies with other financial entities as proposed in S. 2181. However, we believe that these limits should be strengthened and should also be extended to cover mergers between BHCs.

Definition of a Bank

The IBAA believes that fair and effective competition between all bank-owning organizations, and a safe and sound depository system, can only be assured if all such organizations are governed by the same rules and regulations under the Bank Holding Company Act. Therefore, we support the definition of bank contained in S. 1609 which inlcudes, without exception, all depositories eligible for FDIC insurance.

Consumer Bank and Qualified Thrift Lender

The IBAA will not support enactment of any products and services legislation which does not complete the closure of the nonbank bank loophole initiated by the Federal Reserve's revision of Regulation Y. We are adamantly opposed to the creation of a "consumer bank" or any other new, limited charter depository de ling with the public on a retail basis and capable of being owned by organizations which are ineligible to be BHCs.

While the ownership of a single savings and loan institution is explicitly permitted under present law, the substantial commercial lending powers made available to thrifts under the Garn/St Germain Act has opened up the possibility of an unwise and dangerous comingling of banking and commerce through the unitary S&LHC device. Therefore, we support the revised regulation of thrift institutions proposed in the Treasury bill. Further, we support subjecting unitary S&LHCs to the sixty percent of assets in residential mortgages test, and the bar to cross-selling of depository products through the parent company, as proposed by Senator Proxmire.

Grandfathering of "Nonbank Banks"

Any nonbank banks acquired after July 1, 1983 by organizations ineligible to be BHCs should be subject to immediate divestiture. Any such banks acquired prior to that date should be subject to divestiture no later than two years following enactment of the legislation, if the parent organization has failed to conform its activities and bank locales to the requirements of the BHCA.

State Laws Governing Banks and BHCs

The IBAA supports the provisions of the Treasury and Garn bills which would bar a state from prohibiting a national bank from affiliating with a company engaged solely in activities permissable for a BHC.

The IBAA supports the prohibition contained in the Garn bill which bars a state-chartered bank from engaging in insurance activities outside such state on a basis different than that authorized for in-state activities. However, in our view this prohibition should be broadened to prevent any state-chartered bank from engaging in interstate financial activities which are not permitted to a BHC, provided that such prohibition in no way restricts the right of a state to authorize state-chartered banks to engage in financial activities within that state that would not otherwise be permitted to a bank or BHC.

Bank Service Corporations

The IBAA opposes the repeal of the Bank Service Corporation Act. It is crucial to the survival of independent community banks that the option of engaging in those activities available to a bank or BHC as of the date of enactment of the Garn/St Germain Act through a bank service corporation be retained; particularly if such bank or banks chooses not to engage in offering the new products and services which would be authorized by the legislation now under consideration.

Bankers Bank Technical Amendments

The IBAA supports the enactment of technical amendments which clarify that a bankers' bank may provide services to a BHC, and that an export trading company controled by a bankers' bank may deal with the general public.

Payment of Interest on Reserves

The IBAA supports the payment of interest on all reserves required to be maintained by depository institutions. We further urge that reserves be levied against all transaction-type financial products, regardless of whether they are offered by an insured depository, to ensure competitive equity and enhance the conduct of monetary policy.

Consumer Leasing

The IBAA supports the consolidation and simplification of disclosure requirements relating to consumer leasing agreements, as proposed in the Garn bill.

Delayed Funds Availability

The IBAA does not believe that any significant volume of evidence documenting abuses in the area of check holding policy disclosure and crediting has been produced which justifies the imposition of significant new Federal regulatory burdens on depository institutions, particularly small banks. The marketplace incentives for independent community banks to refrain from such abuses is particularly strong, inasmuch as our survival is dependent upon good customers relationships. The IBAA therefore opposes any new regulatory requirements in this area.

Usury Preemption

The IBAA supports the preemption of state usury limits, provided that states retain the right to override such action, as proposed in the Garn bill.

Credit Card Fraud

The IBAA supports the strengthening of Federal laws against the fraudulent use of credit cards.

Interest on Demand Deposit Accounts

The IBAA adamantly opposes the repeal of the prohibition against the payment of interest on demand deposit accounts, and will work to defeat any reported legislation containing such a provision. As a practical matter, the prohibition applies only to commercial checking accounts. Consumers, and businesses with any significant amount of surplus funds, now have a wide variety of interest-bearing deposits available to them. Repeal of the prohibition would seriously jeopardize the profitability, and perhaps the survival, of many independent banks, and would result in a substantial and undesirable increase in the cost of credit to consumers and small business.

Further, we shall oppose any legislation which enables thrifts to offer demand deposit accounts to any business with which they do not have a preexisting loan relationship, as is now required by law, so long as thrifts retain preferential tax and regulatory treatment.

Sanctioning of Regional Interstate Banking

The IBAA adamantly opposes any Federal sanctioning of state laws which limit interstate banking activity on the basis of geographic reciprocity. We will work for the defeat of any reported legislation which contains such a provision or in any other manner explicitly alters the McFadden Act or the Douglas Amendment.

Legislative Moratorium

The IBAA continues to support the enactment of freestanding legislation which closes the "nonbank bank" and "South Dakota" loopholes to the Bank Holding Company Act. However, our strong preference is that these abuses be addressed and resolved in the context of legislation authorizing new products and services to BHCs, and enabling other financial firms to acquire banks under the terms of the BHCA.

# # # # # # # # # #

The CHAIRMAN. Thank you, Mr. King.
Mr. Nicholson.

STATEMENT OF WILL F. NICHOLSON, JR., PRESIDENT, COLORADO NATIONAL BANKSHARES, INC., DENVER, COLO; CHAIRMAN, ASSOCIATION OF BANK HOLDING COMPANIES, ACCOMPANIED BY DONALD L. ROGERS, PRESIDENT, ASSOCIATION OF BANK HOLDING COMPANIES

Mr. NICHOLSON. Mr. Chairman and members of the committee, I am Will F. Nicholson, Jr., president of Colorado National Bankshares, Inc., a $2.2 billion total asset regional banking firm located in Denver, Colo. We currently own and operate 22 commercial banks, an insurance agency, a leasing company, and a mortgage banking company. I am also chairman of the Association of Bank Holding Companies, on whose behalf I am appearing today. Accompanying me is the association's president, Donald L. Rogers, who is well known to many of you.

Although I hear loud and clear what Senator Heinz said, those of us on this side of the table place great significance on the fact that today six national banking industry associations are united in their support for additional securities, insurance, and real estate powers. We believe that these powers are essential for our industry if our institutions are to remain competitive and continue to meet the needs of the American consumer.

Mr. Chairman, I have submitted to the committee a detailed statement, together with a number of attachments, and I ask that these be made a part of the record of today's hearing. I am reading from an abbreviated statement in order to conform to the committee's time limitation.

On January 16, 1984, readers of the New York Times found this message introducing a full-page advertisement by American Express: "American Express knows why people choose one financial service over a competitor's. People want better financial products, consistently delivered and tailored to them."

REGULATORY CONSTRAINTS IMPEDE BANKS OPPORTUNITIES TO COMPETE

The text went on to say that American Express had completed its acquisition of the $18 billion Investors Diversified Services. I am sure that was good news to American Express, but I read the announcement with considerable unease. Unease not because we bankers fear competition and competitive innovation, but rather because regulatory constraints impede our freedom of similar action and competitive innovation.

As the president of a regional bank holding company, I find my business threatened from two sides. On the one hand, I and my colleagues in other regional banking organizations must contend with the likes of American Express, Sears, Merrill Lynch, and Prudential-Bache, which seem to grow stronger as financial providers every day. On the other hand, we also face, day to day, direct competition in our market from large bank holding companies operating from New York, Illinois, Texas, and California. Three of them sit to my left. American Express and similar firms react almost instantly to perceived opportunities in the market; the money-center banks, due to their sheer size and reach, react more quickly than we can to the same situation, even though, on paper, they are subject to the same laws and regulations as our companies. To give just one example, there are over 50 offices in Denver operated by out-of-State banking companies.

This double whammy affecting institutions the size of Colorado National keeps many of us awake at night trying to come up with strategies to enable our regional companies to keep pace with the competition and to continue to prosper or perhaps, if the status quo prevails, even to survive. The problem, as you so well know, is that the banking laws severely restrict the activities of bank holding companies. The restrictions that now prevail make it very difficult for us to develop business plans that promise to succeed in today's environment.

The major question facing Congress, therefore, is whether further deregulation—and by that I mean additional asset powers to go with the liability powers we were given in 1982—will be forthcoming so that regional bank holding companies such as Colorado National can compete. The association supports any and all legislation that permits our institutions to help our customers realize the benefits of increased competition.

The two bills before the committee—S. 2181 and S. 2134—deal with some of the problems bank holding companies face today. I commend both the chairman and the ranking minority member for focusing on these issues. Of the two, we prefer S. 2181, and my detailed statement lists the financial products and services we view as important components of that legislation.

One of the major factors Congress needs to keep in mind as it considers new market powers is the unique role played in local and regional economies by bank holding companies. The contribution by banking companies to the strength and dynamics of local and regional economies and their ability to generate employment, should be a principal concern of Congress. Yet it seems that this vital role of banks in the economy is often overlooked, or taken for granted, even though the banks are engines of prosperity in their areas. You should agree that that statement is not an exaggeration.

Consider, for example, that Colorado National makes more agricultural loans than any other banking institution in the State of Colorado. Through our mortgage banking activities, we have originated and now service some $350 million of mortgages for institutional investors, most being single-family residential mortgages, substantially all of them within Colorado. In addition, our banks have made another $70 million or so in direct mortgage loans to families in the State.

On a personal basis, Bruce Rockwell, chairman of Colorado National, was an original member, and then chairman, of the Denver Urban Renewal Authority for more than 10 years. He was one of the prime movers in the rehabilitation of 27 blocks in the downtown core of Denver. I think it is safe to say that Bruce's role has been replicated by hundreds, if not thousands, of bankers throughout the country. Where one sees an urban redevelopment project, a new hospital or factory, new port facilities, a new youth activities center, or the like, you can be sure there are bankers in the background making these projects work.

Probably more than any other industry leaders, we as bankers are asked to give a disproportionate amount of our time and resources to community projects. And we always try to respond. We do so because we know that the health of our own institutions depends on the prosperity of our cities and regions. To maintain the present economic balance, where regional bank holding companies play a continuing significant role in the lives of our communities, we—the managers of these enterprises—need the ability to compete.

Now for a few minutes, Mr. Chairman, I'd like to address the two basic arguments used against bank holding company expansion—tying and concentration. I am pleased today to be able to provide the committee, as an attachment to my detailed statement, a study just released by Chase, Brown & Blaxall, which places the tie-in charge leveled against bank holding companies in proper perspective. The authors point out that tying, which can also be called bundling or tandem selling, is as old as the Sears Roebuck catalog and has been very effectively practiced by Sears, first as a retailer and now as a financial services company.

The main thrust of the tying argument is based on the erroneous assumption that banks can control credit in a market and therefore can force customers to buy other products. The Chase, Brown & Blaxall study shows this argument to be false. The same conclusion was arrived at independently in another study done for the insurance industry itself by Coopers & Lybrand. Both studies say, in short, that credit markets are so competitive that banks cannot possibly exercise monopoly control.

As a banker in Denver, a highly competitive market by any measure, I cannot understand how the tie-in argument survives. Those 50 offices of out-of-State banking companies in Denver, plus numerous local banks—a total of 400 in the entire State—make the commercial credit market extremely competitive. On the consumer side, the number of credit grantors borders on the fantastic, with banks, thrifts, credit unions, finance companies, industrial banks, and retailers all vying for the same customer. Anyone who thinks Colorado National, or any other Colorado bank, can exercise control over credit in Colorado needs to come to Denver for a visit. I am certain the same high degree of competition prevails in virtually all banking markets in this country.

CONCENTRATION ARGUMENT HAS NO FOUNDATION

The concentration argument used against banking is also without foundation. In fact, I respectfully submit that banking is one of the least concentrated businesses in the country. For example, the 10 largest banking organizations at the end of 1982 held less than 18 percent of total banking deposits nationwide. By contrast, the structure of some industries opposing bank entry into their markets is much more concentrated.

Specifically, in 1980 the top 10 life insurance companies held 52.5 percent of the assets of all life insurance companies, versus, as you will recall, 18 percent for the 10 largest banks. In the securities industry, the top 10 firms in 1982 managed 82 percent of the total dollar volume of underwritten securities. During the first half of that year, those same 10 firms accounted for almost two-thirds of the entire industry's earnings.

These figures suggest two things to me. First, our opponents are trying to turn the concentration argument on its head. It is really their own industries that are concentrated. Second, the public will benefit from bank entry into these very highly concentrated markets: banks will bring greater efficiency, better products and services, and lower costs as concomitants of increased competition.

I understand the proliferation of nonbank banks has been a driving force behind congressional consideration of the legislation before us, and much concern has been expressed about the need to close the loophole in the Bank Holding Company Act. Yet I should like to express a word of caution. It is one thing to argue that the current definition is imperfect. It is quite another thing to produce a better definition that is politically acceptable.

We have, in the space of 1 year, moved from a very broad and rigorous definition propounded by the president of the Federal Reserve Bank of Minneapolis to a definition in S. 2181 that has so many exceptions as to have little force. If such a definition were to be enacted, virtually all competitors of bank holding companies would be free of the bondage of the Bank Holding Company Act, while Colorado National and all bank holding companies would remain its subjects. Of course, if S. 2181 were to be enacted as is, then the impact of the redefinition of bank would be minimal, because we would have the requisite powers to compete.

The association believes very strongly it is incumbent on this committee and the Congress to act in order to achieve some degree of equity among competitors. We favor additional asset powers. However, something needs to be done, and if the asset powers are not forthcoming, then a flat prohibition against entry into banking by nonbanking companies would be preferable to the status quo. The only equitable approach would be one that prohibited affiliations between insured depository institutions and any company engaged in activities impermissible for bank holding companies. Divestitures should be required, and no grandfathering should be allowed. In this way, the clock would be set back, but equitably.

A proposal along these lines has been submitted to Congress by the Federal Deposit Insurance Corporation. Although our association strongly favors enlarging competitive opportunities rather than foreclosing them, S. 1682 is the bill of choice if Congress fails to act on legislation expanding banking asset powers.

How much better for all concerned—the consumers of financial services, our hometowns, and our States—if Congress takes up the challenge of S. 2181 and deals with the issues it contains. This is the only true, long-term solution, since excessive Government regulation is at the root of our industry's current predicament.

Thank you, Mr. Chairman. I'll be glad to answer any questions. And if I may, I'd like to thank Senator Armstrong for his kind remarks.

[The complete statement follows:]

ASSOCIATION OF BANK HOLDING COMPANIES

Statement on S. 2181 and S. 2134
before
Committee on Banking, Housing and Urban Affairs
United States Senate
Washington, D.C.
February 22, 1984

Mr. Chairman and members of the Committee, I am Will F. Nicholson, Jr., President of Colorado National Bankshares, Inc., a $2 1/2 billion total-asset regional banking firm located in Denver, Colorado. We currently own and operate 22 commercial banks, an insurance agency, a leasing company, and a mortgage banking company. I am also Chairman of the Association of Bank Holding Companies, on whose behalf I am appearing today. Accompanying me is the Association's President, Donald L. Rogers, who is well known to many of you.

The Association's members are regional and money-center bank holding companies, currently numbering 180. The Association's by-laws have an unusual provision that requires applicants, as a condition of membership, to designate one of their two ranking officers as "principal representative" to the Association. Only this "principal representative," or the other ranking officer, may attend our Annual Meeting. This requirement can be waived by the Board, but we seldom do so. The net effect of this provision is that the Association is composed entirely of top executives of regional and money-center institutions, which allows for prompt and effective decision-making.

I place great significance on the fact that today six national banking industry trade associations are united in their support for additional securities, insurance and real estate powers. We believe that these new powers are essential for our industry if our institutions are to remain competitive and continue to meet the needs of the American consumer.

Today's Marketplace

Mr. Chairman, on January 16, 1984, readers of the New York Times found this message introducing a full-page advertisement by American Express:

> American Express knows why people choose one financial service over a competitor's. People want better financial products, consistently delivered and tailored to them.

The text went on to say that American Express had completed its acquisition of the $18 billion Investors Diversified Services. I am sure that was good news to American Express, but I read the announcement with considerable unease. Unease not because we bankers fear competition and competitive innovation, but rather because regulatory contraints impede our freedom of similar action and competitive innovation.

As the president of a regional bank holding company, I find my business threatened from two sides. On the one hand, I and my colleagues in other regional banking organizations must contend with the likes of American Express, Sears, Merrill Lynch and Prudential/Bache, which seem to grow stronger as financial providers every day. On the other hand, we also face, day to day, direct competition in our market from large bank holding companies operating from New York, Illinois, Texas and California. American Express and similar firms react almost instantly to perceived opportunities in the market; the money-center banks, due to their sheer size and reach, react more quickly than we can to the same situation, even though, on paper, they are subject to the same laws and regulations as our companies. (To give just one example. there are over 50 offices in Denver operated by out-of-state banking companies.)

This "double whammy" affecting institutions the size of Colorado National keeps many of us awake at night trying to come up with strategies to enable our regional companies to keep pace with the competition and to continue to prosper or perhaps, if the status quo prevails, even to survive. The problem, as you so well know, is that the banking laws severely restrict the activities of bank holding companies. The restrictions that now prevail make it very difficult for us to develop business plans that promise to succeed in today's environment.

The 1984 Report of the Council of Economic Advisers states:

> . . .established firms can find their market positions, expertise, and capital eroded as they attempt to cope with outmoded regulatory constraints while competing against less constrained firms. Regulation, more than restraining competition, forces it into new channels. As a result, resource allocation is distorted, and unnecessary costs are imposed on consumers, shareholders and taxpayers.
>
> (Report to the Congress by the Council of Economic Advisers, January 31, 1984, p. 150.)

This statement appears in the context of a 30-page discussion of the regulatory issues involving the financial services market; I commend the entire chapter to you. However, the major question before Congress, in my view, is whether further deregulation--and by that I mean additional asset powers to go with the liability powers we were given in 1982--will be forthcoming so that regional bank holding companies can compete.

The challenge facing Congress, assuming the answer is affirmative, is to modernize the Bank Holding Company Act in a way that permits our institutions to better serve our customers so they can realize the benefits of increased competition while retaining the basic safety and soundness of the banking system. Such modernization would include guarding against excessive concentration and unfair competition, but these concerns should not be permitted to stymie progress toward necessary reforms, which has been the case up to now. The Association believes that any legitimate public concerns can be met in legislation aimed at lessening the present competitive imbalance.

Competitive Inroads

Using American Express as an example, let me explain in further detail why I am concerned about competitive inroads into traditional banking markets. Two major acquisitions by American Express were completed in a matter of weeks. I am referring to the recent IDS acquisition and the 1981 merger with Shearson, both of which involved very sizeable going concerns. Even while the Shearson merger was being completed, American Express was in the process of acquiring an "out-of-state" bank -- Boston Safe Deposit & Trust Co., an FDIC-insured bank. I can only stand in awe of the speed and flexibility that American Express displayed in these business deals, and envy the obvious absence of federal regulation.

In contrast, at about the same time American Express and Shearson agreed in principal to merge, Colorado National agreed to purchase, from one seller, five banks with total assets of $250 million. Bear in mind we were acquiring banks, not a firm in another financial field. The Shearson--American Express merger was consummated in three months; our acquisition, because of the regulations that exist, took just short of one year. Had there been opposition to the merger, or any questions from the regulators, it would have taken even longer--much longer. More importantly, that year was one in which we could have better served our shareholders and the public if we had been managing the five banks, rather than a management that was in the process of liquidating its own company.

As an executive of a bank holding company, I face similar frustrations every day. We must deal with a law--the Bank Holding Company Act--and court decisions that provide our competitors with too many opportunities to cause delays. Two examples of such deliberate delays are attached to my statement. One (Appendix A) is the history of the proceeding involving the acquisition of a discount broker by BankAmerica Corporation. That proceeding began in February 1982 and is now pending before the Supreme Court. The other (Appendix B) describes a case still pending in a U.S. Circuit Court more than 12 years after the Board issued a general rule permitting the activity. In fact, it seems to me that the chronological history detailed in Appendix B would be even more dramatic if the first date were that of the Board's approval of the activity--September 1, 1971.

Pending Legislation

The two bills before the Committee--S. 2181 and S. 2134--deal with some of the problems bank holding companies face today. Of the two, we prefer S. 2181. The Association believes it essential that Congress enact promptly legislation to allow the banking industry to offer new products and services to the public. The new products and services we view as important components of any legislation are:

(1) underwriting and brokerage of insurance;

(2) real estate brokerage and limited real estate development;

(3) acquisition and operation of savings and loan associations; and

(4) securities activities such as:

  (i) dealing in and underwriting obligations issued or generated by state or local governments;

  (ii) organizing, sponsoring, operating, controlling and advising an investment company and underwriting or selling such company's securities;

  (iii) underwriting and dealing in mortgage-backed securities; and

  (iv) underwriting and dealing in industrial revenue bonds.

These new products and services are needed simply to begin to right the existing imbalance between the heavily regulated banking industry and other providers of financial services. This is not to say that Colorado National would implement initially each and every new power I've enumerated, but it would give management the flexibility to make strategic decisions regarding our future, based on market realities, the economic facts of life, and the needs of our customers, rather than on governmental restraints. As Chairman Garn has said repeatedly, management should make the choices, not government.

The new products and services are not listed above by order of importance. The Association supports all powers equally. I, for one, do not feel at all comfortable in a discussion aimed at dropping one or more of these powers to achieve a "workable" bill. I take that position because I can't see Sears or American Express voluntarily dropping even one of their offerings in the spirit of "fair" competition until the banks have a chance to catch up. So long as I have to compete with these aggressive fellows, we can't afford to bargain away any new powers.

The Association also supports the revision in S. 2181 of the standard in Sec. 4(c)(8) for permissible activities. The test for the permissibility of such activities would be expanded to enable bank holding companies to engage in activities determined to be "closely related" to banking or of a "financial nature." This gives the regulators the flexibility they will need as the demands of consumers continue to change and new products and services therefore evolve. We are also pleased that both bills contain provisions streamlining procedures under Sec. 4(c)(8), and we strongly support them.

Unfair Competition

Those who oppose new activities for bank holding companies generally use as their primary line of attack the specter of unfair competition. Their argument is that banks will use their perceived "control" over the extension of credit to require, or at least to unfairly influence, the customer's purchase of another product or service. This tie-in charge is supported with no hard evidence, other than a few isolated incidents.

Two recent studies demonstrate the inaccuracy of the tie-in charge. The first, which deals directly with the tie-in issue, was undertaken for the

Association by Chase, Brown & Blaxall, and is entitled, "The Role of Bundling in the Provision of Financial Services." A copy of this study is attached to my statement. The second was prepared for the American Insurance Association, an opponent of bank holding company expansion, by Coopers & Lybrand, and is entitled, "Expansion of Banks Into Insurance."

To put the bank tie-in charge in its proper context, it must first be recognized that the bundling of products and services for sale in our economy is a pervasive phenomenon. As the Chase, Brown & Blaxall study points out, such bundling "provides benefits to consumers of all types of goods and services, in terms of lower prices and greater convenience." In most areas of the economy, consumers are allowed to "vote with their pocketbooks" in determining what are the "correct" bundles. The general antitrust and consumer protection laws are designed to prevent abuses. The butcher and the baker may have objected to the growth of supermarkets, which siphoned off many of their customers; however, consumers liked them, and the government allowed the marketplace to decide which businesses would prosper and which would falter.

When does legitimate bundling turn into improper tying? Economic theory tells us that improper tie-ins occur only in two types of cases: (1) when an entity has sufficient economic power over one product to require the purchase of another (the antitrust problem); and (2) when consumers are unable to make an informed choice because they are either misinformed or uninformed (the information problem). In general, the antitrust laws prohibit the first type of situation; the second situation can be, and has been, dealt with by the consumer protection provisions of existing legislation.

The primary argument used by opponents of new activities for bank holding companies is based on a supposed antitrust problem involving banks' power over the extension of credit. Both the Chase, Brown & Blaxall study and the Coopers & Lybrand study demonstrate that this argument is completely false.

The market for credit is highly competitive. Banks provide only about one-fourth of the total credit in the economy, and they compete with thrifts, finance companies, insurance companies, and numerous other lenders, as well as foreign banks. Specifically, banks provide only 44.2% of consumer loans in this country. With respect to such consumer credit, the insurance industry's own Coopers & Lybrand study cites several factors, including "the ability of the consumer to access installment credit through numerous sources outside the (banking) industry" which "make(s) it difficult to support a case for the potential widespread use of credit leverage."

Even though banks do provide 72.4% of short-term corporate credit, this area, too, is also highly competitive. The Coopers & Lybrand study states:

> Both large and small corporations are, in general, no longer tied to one bank. In fact, they are generally less reliant on the banking industry. Most have assured themselves that they will have access to credit before the need arises. Finally, bank competition for corporate business is rapidly expanding. In perspective, this does not appear to represent a marketplace environment which would support abusive credit.

The authors of the Chase, Brown & Blaxall study surveyed filings with the Federal Reserve Board in order to examine the levels of competition in local markets. One filing examined covered 252 markets; in only one of the markets were there as few as 7 competing entities making consumer loans; in only three were there less than 10; and in only 17 were there less than 20. In another case, of more than 180 markets, in only 7 were there less than 10 competitors.

As a banker in a highly competitive market, I am unable to understand how the tie-in argument survives. As I have noted, there are over 50 offices of out-of-state banking companies in Denver, all of which are ready to serve any corporate customer who feels he wants to switch from any of the 400 banks headquartered in Colorado. On the consumer side, Colorado has numerous banks, thrifts, credit unions, finance companies, industrial banks and retailers eager to serve individuals. Anyone who thinks Colorado National can exercise control over credit in Colorado needs to come to Denver for a visit. I am certain the same high degree of competition prevails in virtually all banking markets in the country.

The facts amply demonstrate that the argument about banks' power over the extension of credit is without foundation. Furthermore, even if banks did have the market power to tie other products and services, such tying would be illegal under the antitrust laws. And if this were not enough, there is a specific law applicable only to banks which prohibits tying whether or not the bank in question has market power. This provision, section 106 of the Bank Holding Company Act Amendments of 1970, provides for treble damages and attorney's fees for any party "injured in his business or property" by a violation of the section. Provisions in both S.2181 and S. 2134 would permit trade associations to sue on behalf of their membership for violations of Section 106.

Consumer Information

Consumer information problems, if any, can be dealt with directly by laws requiring disclosure and, if necessary, other provisions such as cooling-off periods. This is the approach taken in section 107 of S. 2181, which provides consumer protections in the case of the insurance sold in connection with an extension of credit. It is difficult to imagine information problems severe enough in the banking area to justify an outright prohibition on bank holding companies' offering particular products and services. Certainly the Congress is capable of drafting adequate consumer protections. The Chase, Brown & Blaxall study points out that "the use of flat prohibitions against the offering of products and services cannot be justified when other, less drastic, legal and economic remedies are available." The study notes:

> Such prohibitions impose a real loss on the consumers of these products and services. This 'lost opportunity' is difficult to quantify, precisely because it is lost. It is nonetheless very real.

The authors then go on to point out a number of the components of this lost opportunity. They basically add up to greater convenience and lower costs for consumers of financial services.

In sum, the tie-in argument, based on the notion of bank control over the extension of credit, has no factual basis and should be labeled for what it really is--a false rationale for protectionism. In addition to its costs to consumers, this protectionism is particularly troublesome for two other reasons. First, the industries that are pleading most for such protection are in general characterized by high distribution costs caused, at least in part, by a lack of effective competition. As the Chase, Brown & Blaxall study points out, the real estate and insurance industries are so regarded, even by their own people.*

Second, the present system of prohibitions discriminates against banking institutions without any justification. If there is a problem concerning tie-ins in connection with extensions of credit, should not the same prohibitions that apply to banks apply to all extenders of credit, including thrifts, credit unions, finance companies, mortgage bankers, furniture dealers and retailers, to name just a few? What possible sense does it make, for example, for two finance companies located across the street from each other to be treated differently in their ability to sell insurance merely because one is a subsidiary of a bank holding company?

The banking industry has indicated on several occasions its willingness to work with Congress to establish consumer-protection measures, such as disclosure and cooling-off periods, to ensure against improper actions by all lenders. We reiterate this willingness. It is our position that any such

*"American Express Chairman James D. Robinson III and Mr. (Sanford) Weil both have been widely quoted as saying that Firemen's Fund is 'a high-cost producer.' And, much of their thinking about expense reductions is likely to sooner or later take the form of rethinking the insurer's distribution system." -- article in Business Insurance, January 30, 1984, p. 73.

consumer protections should apply to all lenders, not just bank holding companies. This can be easily accomplished by placing any new standards in the Truth in Lending Act, rather than in the Bank Holding Company Act or its amendments.

Concentration

Another frequently-stated reason for limiting bank holding company entry into new markets is the specter of financial concentration. Financial concentration is a legitimate public policy concern, and the history of banking regulation reflects this concern. In 1956, for example, the Congress adopted the original Bank Holding Company Act in the face of fears voiced primarily by the independent bankers of that era. However, today, the Independent Bankers Association of America has joined in the effort to secure new products and services for bank holding companies.

The evidence indicates that the need to limit concentration has been overstated--at least for the banking industry. Indeed, excessive efforts to restrict competition in the banking industry have imposed costs on the public. As the 1984 Annual Report of the Council of Economic Advisers states: "Restrictions on competition have not only led to costly inefficiencies in the provision of financial services and reduced consumer choice, but also have contributed to instability." (Page 148).

That the banking industry is not concentrated is demonstrated in the Chase, Brown and Blaxall study. Aside from the statistics previously mentioned, this study indicated that, in 1982, of the $5.6 trillion dollars of "credit market debt" outstanding in the U.S., commercial banks held only 26%. More importantly, the ten largest banking organizations at the end of 1982 had less than 18 percent of total banking deposits nationwide. Thus it would appear that this Committee or the Congress should not overreact to expressions of concern about concentration among the nation's 14,000 commercial banks.

There is greater cause for concern, in our view, about the structure of some of the industries opposing bank entry into their markets--particularly the securities and insurance industries. A 1983 study prepared for the Conference of State Bank Supervisors, and incorporated in your committee's hearing record during the 1983 oversight hearings on the financial services industry, indicates that in 1980 the top 10 life insurance companies held 52.5% of the assets of all life insurance companies.

Similarly, a handful of securities firms dominate the origination and management of corporate securities offerings. In 1982, the top 10 firms managed 82% of the total dollar volume of underwritten securities. During the first half of 1982, those same 10 firms earned almost 2/3 of the entire securities industry's pre-tax profits.

I would submit, therefore, that the opponents of bank entry into these markets are attempting to turn the concentration argument on its head. The banking industry itself by any measure is far from concentrated, yet others, such as insurance and securities, are top-heavy with concentration. Therefore, bank entry into these markets, rather than being harmful to the public, would carry all the public benefits associated with increased competition: greater market efficiency, the development of better products and services, lower costs and increased convenience for consumers.

Finally, our Association is opposed as a matter of principle to Section 104(d) of S. 2181. This section imposes a concentration limitation on the acquisition of non-banking companies by bank holding companies. We are bothered by this provision for several reasons. First, the statistics I have just cited on the concentration of the banking industry indicates that the degree of concentration in banking is overstated. Second, the formula set forth in Section 104(d) is highly arbitrary. Under the formula, Marine Midland Bank (total domestic deposits: $10 billion) would be precluded from purchasing Jefferson Pilot Insurance Company, as an example, while Citicorp (total domestic deposits: $27 billion) would not be so restricted. Third, no other industry is subjected to similar restrictions that are separate from the antitrust laws. Fourth, broad concerns over concentration are more appropriately addressed by modifications to the nation's anti-trust laws. All corporations, including banks, are subject to the Sherman and Clayton antitrust acts. We respectfully submit, simply as a matter of competitive equity, that discussions about concentration should focus on these statutes, not on the Bank Holding Company Act.

What is a Bank?

The question of "What is a bank?" has been at the forefront of discussions in the past several years over the proper evolution of depository institutions as more and more nonfinancial firms have availed themselves of opportunities to purchase these institutions. There are now more than two dozen insured depository institutions, owned by such firms as Sears, Prudential/Bache, E. F. Hutton, Household International, Avco, Gulf & Western, Travelers Corp., American Express, and so on. This has alarmed some observers and left others relatively unconcerned. We are in the latter category.

The Association of Bank Holding Companies has always stood for expansion of competitive opportunity. We have not viewed with alarm incursions of nonfinancial firms into banking. We have, however, chafed under current laws and regulations that conspire to keep our own companies from competing on an equal footing with the new entrants. We have consistently opposed, as we did in late 1983, congressional initiatives aimed at enactment of so-called "moratorium" legislation.

(I might add, Mr. Chairman, we are very grateful for your continued opposition to such action, because we believe any so-called "temporary" solution to this perceived problem would constitute a cure worse by far then the disease.)

The definition of "bank" in the Bank Holding Company Act is perhaps the most important provision in the Act. We have always believed that caution should be used in amending that definition. It is one thing to argue that the current definition is imperfect; it is another to propose a better definition that is politically acceptable. We believe the end result of congressional action would be a definition with many exceptions, particularly for nonfinancial companies now in the depository business, thus depriving it of any meaningful impact.

To illustrate my point, let me go quickly from a theoretical ideal to the definition of "bank" in S. 2181.

One of the most cogent discussions about the role of a bank appeared in the 1982 Annual Report of the Federal Reserve Bank of Minneapolis. The author, President E. Gerald Corrigan, took many pages to discuss the pros and cons of revising the current definition. Toward the end of his essay, Mr. Corrigan proposed his own definition, focusing exclusively on the liability side of an institution's balance sheet. If an institution is eligible to issue transaction accounts, he wrote, then it would be defined--and regulated--as a bank. An institution not eligible to issue transaction accounts would not be a bank. For purposes of "intellectual consistency," he said, it might be necessary to place certain restrictions, such as limiting the number of third-party transfers, on money market mutual funds.

Under Mr. Corrigan's broad definition, existing commercial banks, thrifts, credit unions and virtually all so-called "nonbank banks" would be considered "banks." Needless to say, Mr. Corrigan's essay has provoked controversy.* However, the point is that it is possible to reevaluate and refine the definition of "bank" in ways that are theoretically pleasing. But let us see what happens as we move into the real world.

When the Administration, after consultation with the Federal Reserve

*"On the 'Specialness' of Banking." Richard C. Aspinwall, Vice President, The Chase Manhattan Bank, N.A., in Issues in Bank Regulation, Autumn 1983.

Board, submitted the "Financial Institutions Deregulation Act" last July, it contained a different redefinition of "bank" than the one advanced by Mr. Corrigan. The Administration's definition focused on whether an institution was eligible for FDIC insurance, and it also contained a "grandfather" date for companies that had acquired a bank before July 1, 1983. It covered any institution that accepts deposits that may be withdrawn by check payable to third parties and is simultaneously engaged in the business of making commercial loans.

The practical effect of this definition is to drastically reduce the scope of Mr. Corrigan's theoretical construct. Commercial banks are clearly "banks" under the Administration's definition, but not thrifts, credit unions, or any firms that had acquired a bank prior to July 1, 1983. If this provision had been enacted separately, without the additional powers and other improvements contained in the Administration's bill, then the result would have been a major setback for bank holding companies. Practically speaking, ours would now be the only institutions subject to continuing restrictive banking laws and regulations. Any nonfinancial firm could avoid the onus of the new "bank" definition by purchasing a thrift, either a healthy or failing one.

That is why we have adamantly opposed enactment of the so-called "moratorium" proposals. Because the only moratorium in effect after enactment would be the one we live under every day -- the current Bank Holding Company Act. Our competitors would be largely unaffected by it, while bank holding companies would continue in our existing legal straitjacket.

Moving to S. 2181, the process of producing an acceptable definition of "bank" has led to a number of large, specific exceptions. First, a whole new species is provided for under the rubric of "consumer bank." These entities are defined as any corporation that would otherwise be a bank but does not make commercial loans. Next, there is an exclusion for a "qualified thrift lender," defined as a savings institution having either not more than 25 percent of its assets in commercial-type loans or not less than 60 percent of its assets in various types of residential real estate loans and investments. Also, there is an exception for industrial banks. Finally, I suspect a substantial number of the nation's 14,000 commercial banks could escape the definition by making minor changes in their assets.

Here, it seems to me, the exercise of defining a "bank" has come full circle. The only meaning I can define from the text of S. 2181 is that only banks and bank holding companies (and a few multi-S&L holding companies) are to be subjected to the restrictions of the Bank Holding Company Act. This is virtually what current law provides. And it is a long way from Mr. Corrigan's admittedly theoretical ideal.

The bottom line is that nearly all competitors of bank holding companies would continue free of bondage, while bank holding companies would remain subject to the Bank Holding Company Act.

The saving grace of S. 2181, of course, and of the Administration's bill, is the additional powers and other reforms they contain. Assuming enactment of the entire package, then the effect of the new definition of "bank" is minimal. Without comprehensive legislation, however, the definitions in the bills before you promise to pose further competitive problems for bank holding companies.

Regional and Nationwide Banking

The Association of Bank Holding Companies was the first banking trade association to adopt a position in favor of interstate banking. Our proposal, which was overwhelmingly endorsed by our membership in 1980, amends the Douglas amendment (Sec. 3(d)) of the Bank Holding Company Act to permit a bank holding company to acquire one bank holding company in each contiguous state during the first five years that the bill is in effect. Companies with less than $500 million in assets would not be subject to the numerical limitations during these first five years; those of all sizes would be prohibited from "leapfrogging" from a contiguous state to another state not contiguous to the home state of the acquiring company.

This approach was designed not as the perfect compromise, but to advance the debate regarding the evolving structure of banking, and we believe that it has had an effect. In fact, along with the adoption of the draft bill, the Association's Board of Directors issued a statement to our member companies that included encouragement for individual states to experiment with other approaches. This has indeed happened.

Today, almost four years have elapsed since the Association's formal action regarding interstate banking. We continue to support the contiguous state approach. More importantly from the standpoint of this hearing, however, we are of the firm opinion that the interstate issue in its entirety --and thus Title X of S. 2181--should be deferred until the next session of Congress. The Committee's agenda is now focused on the basic question of additional products and services for bank holding companies and should not be further complicated at this time by debate and decision about banking structure. Therefore, we support deletion of Title X from the bill.

As an addendum, I might note that our Association recognizes that the world has changed since 1980, and we are now beginning a process of reviewing our policy on interstate banking. We plan to have completed the review, and have a newly-authorized position, by November of this year.

Local and Regional Economic Development

It is appropriate to note the crucial role played by regional banks and bank holding companies in the economic life of their communities. Where one sees an urban redevelopment project, a new hospital or factory, a new youth activities center, or new port facilities, or the like, you can be sure there are bankers in the background making these projects work. Probably more than any other industry leaders, we as bankers are asked to give a disproportionate amount of our time and resources to community projects, and we always try to respond. It was easier to do so in those halcyon times of yesteryear, before the invention of the money market funds and cash management accounts. The demands on bankers now are much greater, and the business far more challenging. Yet we are still drawn to community service because we know that the ultimate health of our institutions depends on the strength and prosperity of our localities and regions. This realization continues to make us some of the most enthusiastic and persistent civic boosters around, despite our banking preoccupations.

Some time ago, we asked our members for examples of the kinds of activities they engaged in that were of direct public benefit. Here are just a few of the responses:

-- A bank holding company in North Carolina provided a grant to the University of North Carolina's Center for Public Television to underwrite a weekly series about people of interest living in the State. It was the first such undertaking by a corporation located in North Carolina to fund a locally-produced program.

-- Acting as the lead bank, a Virginia bank holding company obtained construction and low-cost financing for a Boys' Club in Norfolk.

-- In Rhode Island, a bank holding company contributed to save a 50-year old theatre, which has been restored and now serves as the Ocean State Performing Arts Center in Providence.

-- As part of a major urban redevelopment program in Indianapolis, a bank holding company set up classes to train young, unemployed residents in the use of office machines, telephone techniques, office attire, and related subjects to help prepare them for job interviews. Other residents were offered training in residential construction and repair.

-- In Minneapolis, bank affiliates of a holding company joined in providing a $40 million line of credit to a co-op for the establishment of a fructose manufacturing plant designed to employ up to 200 workers.

-- A Michigan bank holding company has invested more than $33 million in industrial development bonds for projects in the State.

-- In Pittsburgh, a bank holding company has been active for years in helping residents of the city's North Side improve their neighborhood by means of flexible loans to individuals and community groups.

-- In Wisconsin, a bank holding company took the lead in arranging a $1 million loan for an addition to the Adams County Memorial Hospital.

As another example, consider that Colorado National makes more agricultural loans than any other banking institution in the State of Colorado. Through our mortgage banking activities, we have originated and now service some $350 million of mortgages for institutional investors, most being single-family residential mortgages; substantially all of them are financing homes in Colorado. In addition, our banks have made another $70 million or so in direct mortgage loans to families in the state.

These are just a few examples of dozens of local and regional efforts by banks and bank holding companies to improve their environments. But a bank holding company is not a philanthropy. It must generate, each quarter, sufficient income to cover costs, add to capital, pay dividends, and provide a base for future expansion. Because of the turmoil in the financial services business, there is no automatic key to prosperity. Previously, if one had a bank charter, it was fair to expect a reasonable return on assets. Not so today. The only thing a bank charter guarantees is a continuing challenge, on a day-to-day basis, to survive. For a bank holding company's management, which usually has responsibility for a number of banks, the challenges are multiplied. To maintain the present economic balance, where regional bank holding companies such as Colorado National play a significant role in the life of our community, we--the managers of these enterprises--need the ability to compete.

Conclusion

The Association of Bank Holding Companies believes that the strength and dynamics of local and regional economies--the building blocks of our national economy--should be a principal concern of Congress. Colorado National and the regional bank holding companies play a significant role as engines of prosperity in their local communities and regions, and we need legislative relief in order to compete against both the unregulated competitors and the larger bank holding companies. S. 2181 provides an excellent basis to help us to make up some of the ground we have lost, and that is why we support it.

We recognize that all of these bills--S. 1609, S. 2134 and S. 2181--raise difficult issues for Congress. But by not acting, Congress is letting things go by default. Some companies, not by skill but by position, have gained, and stand to gain still more. Other companies, including my own, lose under the status quo, and stand to lose still more. Thus, the Association believes it is incumbent on this Committee and the Congress to act in order to achieve some degree of equity among competitors.

I hope I have made our position clear: namely, that we favor additional asset powers for our own companies. Failing that, however, we believe something needs to be done; Congress needs to enact not a "moratorium" but a flat prohibition.

Life is, after all, a two-way street. If a roadblock is to remain, then it should in fairness block traffic in both directions. The only equitable approach would be one that prohibits affiliations between insured depository institutions and any company engaged in activities not permissible for bank holding companies. Appropriate divestiture procedures need to be included, and no "grandfathering" should be allowed.

In this way, the clock would be set back, and the role of depository institutions would revert to an earlier, simpler era. A proposal along these lines has been submitted to Congress by the Federal Deposit Insurance Corporation and it has been introduced as S. 1682. Although our Association strongly favors enlarging competitive opportunities rather than foreclosing them, S. 1682 is the bill of choice if Congress fails to act on legislation expanding banking's asset powers.

How much better for all concerned, and especially for the consumers of financial services, if Congress takes up S. 2181 and deals with the issues it contains. This is the only true, long-term solution, since excessive government regulation is at the root of our industry's current predicament.

I wish to thank you, Mr. Chairman, and the other members of the Committee, for the opportunity to appear before you today and for the attention you are giving to these difficult issues. I would be pleased to respond to any questions that you may have.

Attachments: Study on Tying
Appendix A
Appendix B

Appendix A

BankAmerica Corporation
ACQUISITION OF THE CHARLES SCHWAB CORPORATION
CHRONOLOGY OF EVENTS

February 8, 1982

SCHWAB application submitted to the Federal Reserve Board via the Federal Reserve Bank.

February 12, 1982

Notification letter to the Federal Trade Commission and Department of Justice - copies of the application provided to each of them.

February 25, 1982

Letter from the FTC - application received, the proposed acquisition is exempt from any additional requirements of the Hart-Scott-Rodino Antitrust Improvements of 1976.

March 1, 1982

Letter from the Federal Reserve Bank - further supplemental information required within 10 business days in connection with the SCHWAB application.

March 2, 4, 1982

Supplemental information provided to the Federal Reserve Bank.

March 8, 1982

Acknowledgement receipt letter from the Federal Reserve Bank, received March 9, 1982.

March 12, 1982

Letter to Michael Bradfield, Esq. reaffirming that the application be treated on an individual application process rather than a rule-making proposal.

March 30, 1982

Board of Governors tentatively scheduled a meeting, April 14, 1982, to discuss the form of notice of the SCHWAB application is to be published.

April 6, 1982

Federal Register Notice - BANKAMERICA CORPORATION: proposal to engage in securities brokerage and extend margin credit - comment period ends May 29, 1982

April 16, 1982

Informal meeting between representatives of SIA and the Board's staff to discuss SCHWAB application.

May 19, 1982 - August 3, 1982

Copies of comment letters received from Federal Reserve Board/Bank.

May 28, 1982

Favorable decision by the Department of Justice that a bank holding company such as BAC could properly own and operate a discount securities brokerage firm like SCHWAB.

May 28, 1982

SIA's comment letter opposes the SCHWAB application and requests that the Board hold an evidentiary hearing.

June 21, 1982

BAC's response to the submission of SIA opposes call for a hearing on the SCHWAB application.

June 30, 1982

Board's staff advises that the Board is considering setting the SCHWAB application for hearing.

July 6, 1982

Board's order for hearing on SCHWAB application.

July 19, 1982

Board's order appointing administrative law judge.

July 23, 1982

Board's order setting prehearing conference for August 5, 1982.

August 5, 1982

Prehearing conference.

August 10, 1982

Schedule set as follows:

(1) August 18 - Submission of direct testimony

(2) August 25 - Submission of rebuttal testimony

(3) September 8-17 - Hearing

(4) October 1 - Submission of briefs and proposed finds of fact

(5) October 12 - Submission of reply briefs

(6) November 12 - Filing of recommended decision

(7) November 24 - Filing of exceptions

September 7- 8, 1982

Hearing on SCHWAB application

November 12, 1982

Judge files recommended decision urging the unconditional approval of the SCHWAB application

January 7, 1983

Board's order approving BAC's application to acquire THE CHARLES SCHWAB CORPORATION.

February 22, 1983

SIA sued Fed in 2d Circuit

February 22, 1983

Bank of America granted intervenor status in suit

May 23, 1983

Case argued in court

July 15, 1983

Petition for review denied

October 20, 1983

Petition by SIA in Supreme Court for review of July 15, 1983, decision.

January 23, 1984

Supreme Court grants certiorari

Appendix B

Mercantile Bancorporation Inc.
St. Louis, Missouri
Chronology of Efforts to Provide Property and Casualty Insurance Services

January 1979	-	Mercantile Bancorporation Inc. ("Mercantile") caused the incorporation of a subsidiary, MBI Insurance Agency, Inc. ("MBI Agency") to provide insurance agency services in conjunction with extensions of credit by other Mercantile subsidiaries
February 1979	-	Mercantile filed an application with the Federal Reserve Bank of St. Louis ("St. Louis Bank") to provide, de novo, credit life as well as property and casualty insurance agency services at the locations of its subsidiary banks in Missouri and at the locations of its finance company subsidiary in several other states.
March 26, 1979	-	Mercantile received a letter from the St. Louis Bank that MBI Agency could commence furnishing services after March 29, 1979.
March 28, 1979	-	A letter of protest by the Independent Insurance Agents of America ("IIAA") raising, among other things, some state law issues in states other than Missouri, was delivered to the St. Louis Bank which informed Mercantile that its letter of approval was withdrawn.
March/April 1979	-	The St. Louis Bank requested Mercantile withdraw its de novo notice filing and to file for authority by form FRY-4 for full processing of the Application by the Federal Reserve Board ("Board").
May 1979	-	Mercantile by letter requested, rather than incur the expected delays involved in a new filing, that the authority be restricted to Missouri, avoiding alleged state law issues, and the Application, as thus restricted, be approved.
May/June 1979	-	Counsel to IIAA and Mercantile wrote letters to the St. Louis Bank expanding on their positions.
June 1979	-	Upon indication that the Application would not be approved if not withdrawn, Mercantile withdrew its application to provide property and casualty insurance so that provision of credit life, accident and health insurance de novo by MBI Agency could be approved.

September 1979 - Full FRY-4 Application was filed by Mercantile to provide property and casualty insurance in connection with extensions of credit by its subsidiary banks in Missouri.

November 1979 - Counsel to IIAA filed a letter of protest of the Application. As in the protests previously filed, counsel to IIAA raised objections to Mercantile's application on grounds that are not unique to that Application but rather are common to all such applications. Primarily IIAA counsel alleged that bank customers are at an economic disadvantage with respect to the bankers from whom they seek credit if the bank is offering insurance. They allege that the insurance will be tied to the credit transaction either expressly or impliedly. Such "tying" is illegal under the Bank Holding Company Act and Mercantile had committed not to engage in it.

These arguments were advanced for the last 14 years by the IIAA and its predecessor organizations in attempting (1) to block legislation in Congress which would authorize the Board to approve casualty insurance services, (2) to have the Board's regulations prohibit the provision of casualty insurance services by bank holding company organizations, and (3) in litigation to invalidate the Board's regulations which permitted casualty insurance services. The IIAA was unsuccessful in all such challenges.

November 1979/ July 1980 - IIAA counsel continued to write letters of protest requesting a hearing and essentially reiterating its same arguments. Mercantile counsel replied, urgently requesting action on the Application, then pending for a year and one-half.

August 27, 1980 - The Board approved the Mercantile Application and denied the IIAA request for a hearing on the ground that it had had the opportunity to submit its views.

September 19, 1980 - IIAA filed a petition with the Court of Appeals for the Eighth Circuit ("Court") to review the Board's order.

October 1980/ March 1981 - Extensive briefs filed by IIAA, the Board and Mercantile.

June 16, 1981 - Oral argument by the parties before the Court.

September 1, 1981 - The Court ordered the matter remanded to the Board which it ordered to hold a full evidentiary hearing.

October 1981 - The Board and Mercantile petitioned the Court for a rehearing.

November 1981 - Petition for rehearing was denied by the Court.

January 1982 - The Board ordered a full formal public hearing on Mercantile's application.

February-May 1982 - Administrative Law Judge ("Judge") appointed by the Board held prehearing conferences to determine procedures. The parties, especially the IIAA, filed requests for production of voluminous documents and answers to numerous interrogatories.

Parties prepared and filed written direct testimony of witnesses.

June 1 through 8, 1982 - Public hearing held before the Judge for cross examination of witnesses whose direct testimony had been submitted.

June-July 1982 - Post-hearing procedures.

July-November 1982 - Parties prepared and submitted extensive findings of fact, conclusions of law and briefs.

January 12, 1983 - The Judge filed his findings of fact, conclusions of law and recommended decision with the Board.

January-March 1983 - The parties filed detailed exceptions to the Judge's findings and recommended decision.

May 31, 1983 - The Board again approved Mercantile's application, finding against all of the IIAA's contentions.

August-October 1983 - The parties' briefing schedule set by the Court.

It is unlikely that this case will be determined before the end of 1983. Accordingly, assuming a favorable result before the Court, it will be approximately five years since Mercantile began its plans to offer property and casualty insurance services before its authority to do so will have been established.

THE ROLE OF BUNDLING IN THE PROVISION OF FINANCIAL SERVICES

A Study for the Association of Bank Holding Companies

February 1984

PREFACE

In this era of rapid change in the technology and structure of the financial services industry, innovative packaging, or bundling, of services is essential if consumers are to be well served. This study was prepared for the Association of Bank Holding Companies for the purpose of clarifying the economics of bundling as it relates to consumer welfare.

We are grateful to Edward L. Yingling of Barnett, Yingling & Shay for indispensable assistance and advice with respect to statutory and legislative matters and helpful criticism and advice at various stages of the project, which added greatly to the clarity and focus of the paper. We also wish to thank Maika Dueitt for research assistance. Final responsibility for the facts and analysis presented herein must, however, rest with the us.

February, 1984

John Prather Brown
Samuel Chase

Chase, Brown, & Blaxall, Inc.
Washington, D.C.

I. INTRODUCTION

Congress is considering a proposal from the Reagan Administration, S. 1609, to allow bank holding companies to expand their non-bank activities in areas such as real estate, insurance, and securities. Senator Garn, Chairman of the Senate Banking Committee, has recently introduced an amended version of this legislation (S. 2181) which provides essentially the same new powers.

As would be expected, this proposed legislation has generated opposition from industries with which bank holding companies will compete if it is enacted. Strong opposition has been raised by the securities industry, insurance underwriters and agents, and realtors, among others.

A principal argument used by these groups in opposing expanded powers for bank holding companies is the potential for unfair competition. Specifically, the charge is made that banks and bank holding companies are able to use unfairly their unique control over certain financial products or services, usually the extension of credit, to require or influence the purchase of another product or service. In other words, it is charged that banking organizations are able to use a product or service over which they somehow have a unique power -- such as a loan -- to force, or tie, the customer's purchase of another product or service -- such as insurance on the item being financed.

The Bundling of Financial Services

To give one example, in a 1980 Senate hearing, the Independent Insurance Agents of America, perhaps the most vocal proponents of the bank tie-in theory, testified as follows:

> Banking organizations are the principal source of commercial credit in our economy. As such, they dominate a vital element of the economy. Their control over loans provides them with a unique opportunity to influence where borrowers purchase any nonbanking service that might be sold in conjunction with extensions of credit.

Proponents of expanded activities for bank holding companies have for many years put forth a number of basic arguments to counter the tie-in charges. Among the arguments are these: (1) the offering of new products and services will provide additional competition and increased convenience for customers; (2) lower prices due to more efficient bundling of products and services and increased convenience are the real concerns of competitors, who are using the tie-in argument merely to protect themselves from competition; (3) in any event, individual banking organizations do not possess the requisite economic power over the tying product to coerce the purchase of the tied product -- in fact, there are numerous sources of credit; (4) there is no reason to discriminate against banking organizations since any potential problem with respect to tying in the credit granting process would apply to the many other grantors of credit as well, and (5) improper bank tie-ins are prohibited by section 106 of Bank Holding Company Act Amendments of 1970, which would be further strengthened under the Administration and Garn proposals.

The Bundling of Financial Services

Opponents of expanded powers have repeatedly put forward the tie-in argument as though it were a truism. No analysis of the theory of tie-ins as it applies to banking has been set forth, and only a few isolated cases of supposed unfair tie-ins in the banking industry have been cited.

The proponents of expanded powers have also done little to explain their counter arguments, although they are able to cite the favorable conclusions of a study that appears to be directly on point -- the Federal Reserve Board's 1979 examination of tie-ins in the sale of insurance by bank holding companies and other lenders. If expanded powers are to be granted to bank holding companies, concerns about the potential for tie-ins expressed by Members of Congress and other policy makers need to be addressed more fully.

Not only has the debate been too shallow, it has been too narrow as well, because it has largely ignored possible gains from the "bundling" of financial services. Proponents of expanded powers, as mentioned previously, have raised the issues of consumer convenience and lower costs, but defensively and sketchily.

The debate will be improved by focusing on the critical public policy issue -- the best interests of consumers of financial products and services. Section II considers the appropriate role of bundling products and services generally. It distinguishes carefully between beneficial and harmful bundling. For cases where bundling is harmful, possible remedies are explored. They range from greater disclosure to consumers through outright prohibition of a particular bundle. In Section III the principles developed in Section II are applied to the market for financial products and services, taking into account the specific characteristics of that market. The potential for coercive tie-ins by banking organizations is considered there, as is the likelihood that bundling may serve consumer needs more efficiently. Section IV applies the conclusions on the appropriate bundling of financial products and services to some of the specific activities contemplated in legislation now before Congress.

II. THE CENTRAL ROLE OF BUNDLING IN A MODERN ECONOMY

A. THE LOGIC OF BUNDLING

There is a superficial and rhetorical attraction to the arguments of those who would find fault with potential competitors for engaging in tie-in sales. These arguments suggest a world where there are stable, well-defined, elementary commodities. When a monopolist in one of those commodities tries to combine the sale of that commodity with another, he is up to no good and there ought to be a law against it. However, the underlying logic of commodity and service bundling makes the issue considerably less simple and clear-cut.

Most sales are tie-in sales. Nearly all commodities are divisible. They contain components that could, in principle, be sold separately. In most cases involving goods, we can point to physical components. New cars have tires; one could well imagine seats or engines being sold separately from new cars; they are sold separately in some kinds of large trucks. Tires, too, have separate and separable parts.[1]

What is true for something as simple and direct as a car tire is even more true when dealing with more complex goods and services. To take an example, data processing vendors sell remarkably complex bundles of services to their customers. The bundles generally include the use of a computer at a particular time, the use of peripheral equipment, the use of particular software, paper, computer operators, clerks, pick-up and delivery services, financing, insurance, management, and much more. Each of these items could be sold separately by different vendors. Each of those vendors might see the data processor as a perpetrator of tie-in sales. The clerk who used to prepare the payroll, the messenger who used to deliver the checks, the office supply store that used to sell the paper to the company, the insurance salesman who no longer sells business machine insurance riders, and many others would look at a data processor offering a payroll package to a new customer as a tie-in seller who takes business away from him. And indeed, that is the case. Not many years ago the data processors did not even exist. Their coming onto the scene was very disruptive of existing business relationships.

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[1] Even if we could find a situation where physical separability was implausible, one can separate contingencies so that ownership under one contingency does not necessarily imply ownership under another. For example, you may own an elemental ton of wheat stored in my grain elevator, but if that grain explodes due to my negligence, we have a separable contingency. The ownership of a ton of "wheat" is actually the ownership of a large bundle of contingencies. The sale of a ton of wheat is a tie-in sale of that bundle of contingencies. From this point of view, many legal problems of contract can be viewed as disagreements about what bundle of contingencies was exchanged at the sale. The very sophisticated development of the economics of contingent commodities is one of the major contributions to economics made by Nobel laureate Kenneth Arrow. See Kenneth J. Arrow, Essays in the Theory of Risk-Bearing, Chicago, 1971, especially chapters 2 and 3.

One can even argue that, from a strict logical point of view, all commodities are bundles, or tie-ins, so all sales are tie-in sales. In any case it is simplistic and dangerous to design public policies that overlook the pervasive nature of bundling, and therefore of tie-ins.

Several points are crucial. First, there are few simple, elemental commodities or services. They are nearly all bundles. Second, bundles that are available in the marketplace change over time, and appropriately so. Some things that used to be sold separately are now sold together; some things that used to be sold together are now sold separately. Third, the question of what bundles should be provided depends on technology and tastes, and is one that has traditionally been left to markets. As a general matter, it is in marketplaces that these questions are best decided .

One can usefully distinguish three different kinds of bundling:

1. selling different goods or services in the same place;
2. selling a group of goods or services together while allowing a customer to choose not to buy some of the group; or
3. selling several goods or services together with no opportunity for the consumer to buy only part of the package.

Selling different goods or services in the same place. Cigarettes are sold in restaurants; cosmetics, newspapers, sodas, and prescription drugs are sold in drug stores. In both cases the obvious reason is customer convenience. Furniture, clothing, and appliances are sold in department stores partially for customer convenience, but perhaps more importantly for another more subtle reason.

Many of the things sold in a department store are things about which a consumer is not fully informed, and about which full information would be difficult or costly to obtain. Under such circumstances it is unlikely that most buyers can do a thorough job of searching for the best combination of price and services. Instead, the market develops structures which reduce the need for consumers to shop carefully. Careful shopping for complex and unusual goods or service requires something rare and valuable--a combination of curiosity, technical ability, learning ability, market prowess, and time--that may be better put to use in earning a living, raising a family, or just relaxing.

When consumers buy any number of sophisticated goods and services, from burglar alarms to video cassettes, they face the same problems they face in buying insurance, banking, and real estate brokerage and settlement. How do consumers overcome their shopping problems in these other markets? The answer is simple: rather than do their shopping themselves, they find other people to do the shopping for them. A person facing heart surgery relies on his surgeon to arrange for an anesthesiologist. A person looking for a digital watch delegates to the watch manufacturer the task of seeking out the most efficient supplier of computer chips. For many goods consumers can rely on the reputation of an established retailer to ensure that they get good quality for their money. This leaves to the retailer the difficult task of choosing which manufacturers' products should be bought. They are rewarded for the simple reason that consumers are willing to pay them handsomely for the service. Any public policy that restricts the ways consumers can delegate their shopping tasks to others is likely to do more harm than good. In particular, artificial restrictions on the sensible bundling of goods and services should be looked at with a jaundiced eye.

Selling a group of goods or services together while allowing a customer to choose not to buy some of the group. Car rental contracts allow the renter to buy extended insurance coverage at a particular cost or not, as the renter chooses. Automobiles are sold with certain features standard and others extra. Having the dealer provide extras such as radios and air conditioners, which can be bought elsewhere, provides the consumer with both shopping convenience and with the *imprimatur* function that assures that the extra meets the auto manufacturer's standards of quality.

Bundling of several things into one homogeneous product with zero marginal cost for components. This is the way that most goods and services are provided in a modern economy. Goods and services are provided in a fixed and finished manner; there is no opportunity for the buyer to negotiate with the seller about the makeup of the bundle. His decision is to buy or not to buy. Just about everything sold by Sears or K-Mart or Safeway comes as is; the consumer cannot bargain to change the warranty coverage, or buy ten instead of a dozen eggs or buy a Sony TV without the standard loop antenna which he does not need. The reasons for the bundling are lower costs. Marketing, retailing and manufacturing control are all much more expensive when there is variety, so options have to be carefully watched. The number and scope of options is a matter with significant economic consequences. Too much variety will result in costs that are too high; too little variety means potential loss of market share. A balance must be sought, and that balance should change as technological change affects costs and as changes in consumer taste and income change demand.

B. THE ECONOMICS OF BUNDLING: WHAT BUNDLES SHOULD BE PROVIDED?

The major economic issue in bundling is what bundles should be provided. Of all the bundles that are technologically feasible, which are most efficiently produced and most responsive to consumer tastes?

For purposes of this discussion, the most instructive area of the economy is retailing, because, in fact, banks are retailers. This view suggests that we should look to retailing for instructive analogies to predict the potential future of banking organizations.

The critical choices a retailer makes are bundling and pricing. What goods and services shall I provide? What levels of quality and service should characterize my business? What goods should be brought together in my store? What price should I set for each?

Late in the 19th century the retailing giants of America - Marshall Field, John Wanamaker, J.C. Penney, and Sears - revolutionized many markets by staking their reputations as retailers on the quality and price of the goods that they sold. They sold a very broad range of goods. As a result, they were in competition with a vast array of other, more specialized retailers of particular items. By selling a broad range of goods and services, they deliberately made themselves more vulnerable to dissatisfied customers, in order to convince the world that customers would not be dissatisfied in their store.

Even today when, for example, Sears sells a customer an Allstate insurance policy, its reputation is at stake. If the policy is unsatisfactory to the customer, not only will the customer not renew the policy, but Sears' reputation will suffer. That can hurt sales in every department, not just insurance.

At the same time, insurance firms which compete with Sears have lost business to it because of consumers' access to Sears' reputation. Those firms now have added impetus to improve their reputation by a variety of methods; these methods include price competition, warranties, extra services and so forth. Thus, the benefits of the department store accrue not only to the department store itself and its customers, but also to customers of competing firms throughout the industry.

Historically, the emergence of department stores had an enormous beneficial effect on prices and on quality. The simple fact that they sold a broad range of items made it pay for retailers to go to great lengths to satisfy their customers. Their reputation with consumers was essential to their commercial success and allowed them to guarantee the quality and reasonable price of products unfamiliar to the consumer. Customers can go to a large retailer, buy a complicated product they may not understand, and be confident that they are getting a quality product at a reasonable price.

The economic history of supermarkets is equally fascinating. Supermarkets were a response to a number of technological changes-- in particular, refrigeration, the widespread ownership of automobiles, and a strong desire by consumers to shop less frequently. Instead of a trip to the friendly local grocer for each day's food, consumers responded to the opportunity to shop once, in one place, for food for several days or even a week. Supermarkets substituted consumers' own time and effort to take things from shelves for clerks' time; they substituted a longer trip, larger interior space, parking space, and lower prices for the nearby friendly local store. The butcher shops, the bakeries, the greengrocers, and, above all, the mom and pop stores raised a hue and cry about the relentless juggernauts like A & P, but consumers thought otherwise.[2]

Now, a half century later, as technology, tastes, and costs have changed, quite different retailing strategies are being developed. We see all kinds of specialty shops and boutiques springing up, individually and in malls, often in the wake of, and in proximity to, a lead draw store.

The moral of this fascinating history is that bundling is the essence of retailing, and that effective bundling is one of the most important generators of consumer benefits. The bundle that is appropriate depends on technology, on costs, and on consumer tastes. Since technology, costs, and consumer tastes are constantly in flux, so, too, will the appropriate bundles be in constant flux. Legal restrictions on bundling, particularly restrictions on retail bundling, are very likely to have a serious harmful effect on consumers.

C. THE PUBLIC POLICY ISSUE: WHICH BUNDLES SHOULD BE PROSCRIBED OR REGULATED?

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[2] See M.A. Adelman, A & P: A Study in Price-Cost Behavior and Public Policy, Harvard, 1966, for a careful review of the early history of supermarkets. One of the most fascinating corners of this history discussed by Adelman is the Chain Store Act, which was proposed by Congressman Wright Patman, but was ultimately defeated. It was a response to the Populist nightmare vision of the twenties and thirties of every street corner in America having an A & P, a Sears, and a Standard Oil station. The Act would have taxed stores at a nominal rate, but that rate was multiplied by the number of stores the chain had, and by the number of states the chain was in. As a coup de grace for the sensible chains, it would exempt them from the tax if they committed to going out of business within two years!

The Bundling of Financial Services

Just as some bundles provide great benefits to consumers, some do not. Some bundles include too much, some bundles include too little. The usual way a market handles this problem is for customers to vote with their pocketbooks, and the bad bundles disappear. There are circumstances, however, where one cannot expect this solution to work. The first is where the bundling is the result of a monopolist in one area trying to extend its scope into another area. The second is when consumers are uninformed about the bad aspects of the bundle and therefore cannot effectively vote with their pocketbooks. Thus antitrust problems and consumer protection problems deserve further scrutiny.

There is a traditional antitrust approach to bundling.[3] It contemplates a situation in which the sale of a monopolized product is tied to the sale of some non-monopolized related commodity in order to "expand the scope" of the monopoly. Under antitrust law, if a buyer of one product is also required to buy another (the tied product) and if the tie-in arrangement affects a significant amount of commerce in the market for the tied product, the antitrust laws are violated.[4]

The traditional concern is for competition in the tied industry. The classic example is a monopolist of card sorters tying the sale of sorters to a requirement to buy the punch cards from it, at a premium, as well.[5]

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[3] See Laurence Sullivan, Handbook of the Law of Antitrust Section 150 at 431, (1977).

[4] See Richard Craswell, "Tying Requirements in Competitive Markets: The Consumer Protection Issues", 62 Boston University Law Review 661, at 664 (1982).

A prominent court decision on tying, United States Steel Corporation v. Fortner Enterprises, Inc., 429 U.S. 610(1977) involved the use of an extension of credit as the tying product. In that case, U.S. Steel agreed to finance Fortner's cost of acquiring and developing land as part of an agreement under which Fortner, a real estate development company, purchased prefabricated housing from U.S. Steel. Fortner brought a treble damage suit under the Sherman Antitrust Act claiming that competition in prefabricated housing was restrained through the abuse by U.S. Steel of its power to grant credit. In other words, Fortner claimed that U.S. Steel was using its ability to grant credit, the tying product, to coerce Fortner to buy prefabricated housing, the tied product.

The Supreme Court overruled the lower courts and held that U.S. Steel did not have sufficient economic power in the market for credit to have violated the antitrust laws. The record showed that U.S. Steel did grant uniquely liberal terms on its credit, but the Supreme Court stated that such uniqueness did not give rise to any inference of sufficient economic power with respect to the market for credit. The court held that, although it was not necessary for the defendant to have a monopoly or even a dominant position in the tying product's market, it was necessary to show that the defendant had the power to raise prices or impose burdensome terms.

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[5] There are important analytical problems with looking at the issue in this way. It is not at all apparent why the monopolist would benefit from this strategy nor why society is harmed. Any requirements that potential buyers would find odious, like overpriced punch cards, would reduce the value to them of the monopolized or tying good, reduce its price, and therefore offset the gain of the higher prices for the tied product. It is by no means clear that expanding the scope of a monopoly increases its value. Under ordinary circumstances, the best way for a monopolist to exploit his monopoly is simply to raise the price of the monopolized product to the monopoly level. Getting involved in tying simply complicates matters. These matters have been much discussed in the economics literature as well as in legal writings. See Richard A. Posner, Antitrust Law: An Economic Perspective, 171-84, 1976 and Ward Bowman, "Tying Arrangements and the Leverage Problem," 67 Yale Law Journal 19 (1957).

Consumers also enter into injurious tie-in arrangements when they are ignorant, uninformed, or unaware of the consequences of the agreement.[6] These problems can arise without any market power whatsoever on the part of the seller. They can come about through fraud or surprise. People think they are getting one bundle and they get another, worse one instead. The old book and record clubs are a classic example: a person sent in a coupon for the come-on and found himself committed to buying books forever, or so it seemed. More recently, stripped down models of home computers have been marketed at low prices. People have been sadly surprised to find out that they are almost useless without a significant amount of expensive peripheral equipment.

Another problem that can arise from insufficient information has been called "opportunism" by one commentator.[7] In this case, the tie-in is not apparent until after the transaction, when the seller threatens to withhold the tying product unless the buyer buys the tied product. This problem arises occasionally with franchises. Uninformed franchisees buy a franchise and find out that they must buy tied products from the franchisor or lose the franchise.

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[6] The clearest exposition of the consumer protection aspects of tie-ins is Richard Craswell, op cit.

[7] See Craswell, op cit. at 674.

Consumers can be unaware that they have a choice. Often, for example, title insurance policies can be improved in their coverage just for the asking, a fact that real estate attorneys know, but consumers do not. Getting these "concessions" makes the attorney look good, but the consumer could have gotten the same policy if he had only known to ask.

Sometimes consumers are unable to make appropriate choices. Children, the aged, the infirm, the credulous, all find themselves engaged in transactions potentially beyond their capacity and subject to abuse.

One has to make these consumer protection arguments with great care, because it is a deep structural characteristic of a complex, modern, technological economy that consumers do not, and indeed need not, understand all material aspects of many or most of the transactions into which they enter. Millions of Americans own common stock. Each and every transaction on the New York Stock Exchange is bundled with or subject to the very complex rules of the New York Stock Exchange and to rules of the Securities and Exchange Commission. Similarly, billions of dollars are held in money market funds. These funds are subject to the rules of the fund and the rules of the Securities and Exchange Commission. In each case virtually no consumer is fully informed about material aspects of the transaction. Nonetheless, these rules, and as a result, these markets, work remarkably well. Well functioning markets serve the purpose of economizing on the need for consumers to inform themselves. Markets for goods, like markets for financial instruments, tend to highlight important characteristics such as price, and standardize less important characteristics.

D. PUBLIC POLICY REMEDIES WHEN PROBLEMS ARISE

As stated above, there are two important causes of inappropriate bundling: monopoly problems and information problems. Some of these inappropriate bundles may be harmful enough to call for intervention by government through the legal system. We shall now briefly review the available remedies and the considerations appropriate in making a choice of remedy.

1. Prohibit the Offending Activity. A prohibition is of course the most restrictive available remedy. It is powerful, apparently direct, and often politically attractive. However, it benefits consumers only when most or all consumers who had bought the service or activity would, on becoming fully informed, willingly pay to get out of the deal. Outright prohibition is potentially quite insidious because often the costs are invisible inasmuch as the prohibition aborts a dynamic process -- the development of market institutions. The people who are most harmed by the prohibition usually do not know it because they never learn how they would have benefitted. In sum an outright

prohibition should be used only when less drastic remedies are clearly not sufficient to solve the problem.

2. Leave Decisions to the Market Aided by the Antitrust and Consumer Protection Laws. Markets alone are very powerful. Bad ideas have a hard time surviving in the marketplace; low cost or high quality competition usually wins. Selling a bundle that consumers really do not want invites effective competition. Antitrust and consumer protection laws ensure that this market mechanism is allowed to work. The antitrust laws protect against coercive tying by a monopolist, and consumer protection laws help with information problems.

3. Adopt Targeted Antitrust or Consumer Protection Remedies. When the tie-in is a result of an information problem, then the best remedy is often an information remedy. It might be appropriate to require the disclosure of the existence of the tie, or perhaps only of the full cost of the tie. Further, there are the usual important disclosure issues of time, place, and manner. What is sensible to require on a package insert is unlikely to be sensible to require on a television ad. Policy makers must remember to balance the costs of each additional level of disclosure.

III. CHARACTERISTICS OF THE CREDIT MARKET

A. Analysis of the present structure of the credit market

Before applying the general analysis of bundling to the offering by bank holding companies of a broader array of financial services, it is necessary to establish a factual background. First, a close look must be taken at the market power of banking organizations in the extension of credit.

There is a persistent myth to the effect that banks have a "lock" on credit markets which gives them a unique ability to require their loan customers to buy other services as a condition of receiving approvals of loan applications. Lack of evidence to support this proposition is customarily made up for by rhetorical flourishes to the effect that "everybody knows" coercive tying to credit extensions is a weapon commonly employed by banks. However, the facts do not support the flourishes.

Before considering detailed data on competition in the credit markets, it is useful to note that for a number of years the commercial banking industry has become increasingly competitive. This is partly a reflection of deregulation and its intended companion -- vigorous competition both within banking and between banking and other, competing financial sectors. The market for equity securities of banks and bank holding companies reflects this vigorous competition. Not only do bank and bank holding company stocks generally sell at low multiples relative to earnings, but for a large segment of the industry, bank stocks trade at prices below book value. These facts do not square well with the myth that banking is a monopolistic industry.

In analyzing credit markets, it is necessary to look beyond banking because, in virtually every area of lending, banks face strong competition from other providers of credit. The most authoritative and comprehensive data on credit flows in the U.S.

-- the Flow of Funds statistics published by the Federal Reserve Board -- make this clear .

At the end of 1982 more than 5.6 trillion dollars of "credit market debt" was outstanding in the U.S.[8] The commercial banking sector held only about 26 percent of this total, and savings organizations -- savings and loan associations, mutual savings banks, and credit unions -- about 15 percent. Moreover, as Figure 1 shows, the shares of total credit supplied by both banks and thrift institutions have fallen significantly in the last decade.

Figure 2 shows shares of banks in non-mortgage loans to various sectors of the economy: at year-end 1982 commercial banks accounted for less than half of total lending to consumers; they also held less than half of all short-term loans to both farms and unincorporated nonfarm businesses. Among the major types of non-mortgage borrowing by domestic nonfinancial entities, only in short term loans to the corporate business sector, where large syndicated loans are common, did banks account for over half of total lending. In addition, commercial banks accounted for less than 20 percent of all mortgage loans outstanding.

Although the foregoing data dispose of the argument that banks have a unique position in the credit markets, it might be argued that for those portions of the market they do serve, they have monopolistic power that enables them to exploit credit

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[8] Federal Reserve Board, Flow of Funds, August, 1983, page 52, line 1.

FIGURE 1
PERCENT DISTRIBUTION OF
CREDIT MARKET DEBT, BY
HOLDER
YEAR-END 1972 AND 1982

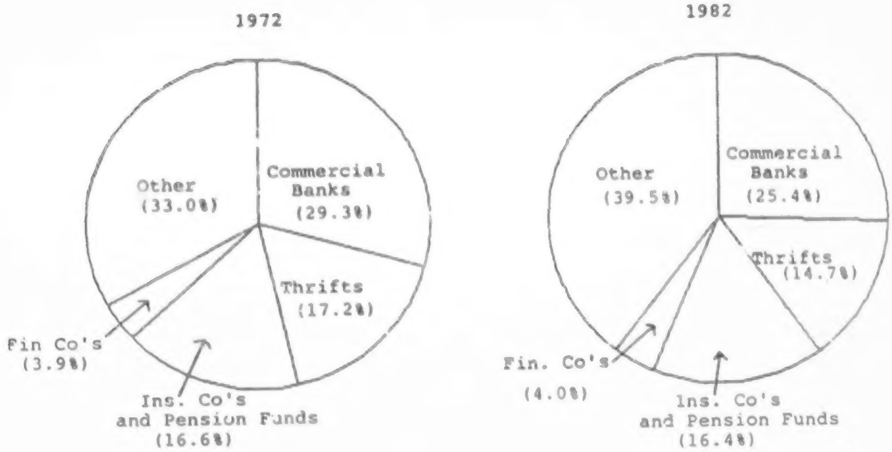
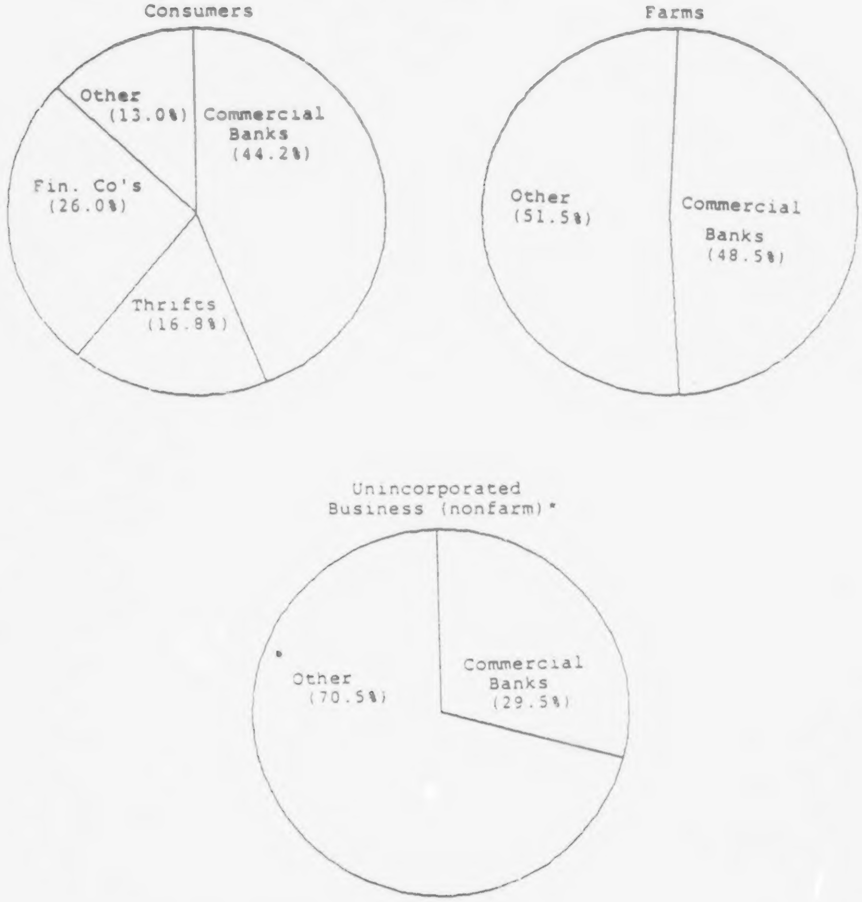


FIGURE 2
NON-MORTGAGE DEBT
BY TYPES OF BORROWER
AND BY HOLDER
YEAR-END 1982



*Nonfinancial firms only; figures exclude mortgages and trade debt.

customers by devices such as coercive bundling from which borrowers have no escape.

Concentration among a few firms is a necessary precondition for the exercise of monopoly power, whether through coercive tie-ins or otherwise. As of December 31, 1982 the nation had some 12,000 banking organizations -- i.e. bank holding companies which owned one or more banks, and non-holding company banks. The ten largest organizations accounted for less than 18 percent of all bank deposits in the country, and there were less than 400 banking organizations with total assets in excess of $500 million. Only three states had less than 20 banks, and all of these permit statewide branching, so that numerous banks meet and compete in markets throughout the state.

Moreover, the major types of lending institutions that compete with banks are made up of hundreds or even thousands of individual firms spread across the country, including some 3800 savings and loan associations, 400 mutual savings banks, and 20,000 credit unions. Like commercial banks, most thrift institutions and finance companies tend to be relatively small.

The unconcentrated nature of these industries and the ease of entry of new firms, or new branches of existing firms, heightens both inter- and intra- industry competition. This competition has increased as a result of 1980 legislation which gave federally chartered savings and loan associations new powers to make both consumer and business loans. These new powers have tended to eliminate the last vestiges of protection from competition in various specialized areas of bank lending by bringing additional competitors for retail credit services even to smaller communities .

The most critical geographic areas of competition are local credit markets. Because there are so many local markets, detailed information on competition in them is difficult to find. One useful source, however, is information submitted to the Federal Reserve in connection with bank holding company applications. Two relatively recent applications by bank holding companies to acquire sizeable finance companies contain detailed information in the public record. The applications list the principal competitors faced by offices of the finance companies to be acquired in each local market in which they operate.

The information presented in these official filings with the Federal Reserve is remarkable. In one case, in only one of the 252 markets surveyed were there as few as 7 competing entities making consumer loans; in only 3 were there less than 10 such competitors and in only 17 were there less than 20. In the other case, of more than 180 markets, in only 7 were there less than 10 competitors and in only 35 were there less than 20.

In nearly all of the local markets covered by the applications, other lenders outnumbered commercial banks significantly. Significantly, these figures were compiled before savings and loan associations had had time to respond to the enhanced consumer lending powers conferred by the federal legislation in 1980.

If the savings and loan associations were added, the lack of dominance of banks would be even more striking.

The Bundling of Financial Services

In light of facts such as those presented above, it is little wonder that in a widely-quoted study prepared in 1972 for the National Commission on Consumer Finance, Paul F. Smith concluded that

> ...the evidence supports the existence of strong competitive forces in...the market [for consumer credit]. The only evidence of imperfections...appeared in the market for high risk loans and a question of interpretation arises even in this case... ...competitive forces are present and are achieving the type of results we would expect.[9]

To summarize, banks do not have the market power that would be required to coercively tie other products to their extensions of credit if customers did not want the bundled packages. Recent moves to deregulate competition in banking make bundling of any kind less likely to occur unless consumers prefer it. Formerly, under the extensive system of deposit rate ceilings, banks had incentives to grant credit on more favorable terms to customers who held substantial deposit balances. Now that incentive has all but disappeared, since deposit rate ceilings are almost completely phased out.

B. Present law prohibits tie-ins by banking organizations

Above and beyond the antitrust laws, there is an express prohibition against bank tie-ins in the 1970 Amendments to Section 106 of the Bank Holding Company Act. As was pointed out in Section II, the courts have ruled that tying arrangements are per se unlawful under the antitrust laws when a "not insubstantial" amount of interstate commerce is involved and when there is enough economic power over the tying product to affect competition in the market for the tied product. Nevertheless, despite the existence of this antitrust remedy, in the 1970 Amendments to the Bank Holding Company Act the Congress provided an additional, stronger prohibition, applicable only to banks, with respect to tie-ins.

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[9] "The Status of Competition in Consumer Credit Markets" by Paul F. Smith, Technical Studies, Vol. III, National Commission on Consumer Finance, 1972, pp. 1-2.

This additional prohibition, which was added in the Senate, provides that no bank shall "in any manner extend credit lease or sell property of any kind, or furnish any service, or fix or vary the consideration for any of the foregoing" on the condition that: (1) the customer shall obtain some additional credit, property, or service from the bank, the bank holding company owning the bank, or a subsidiary of the bank holding company; (2) the customer shall provide some additional credit, property, or service to the bank, the bank holding company, or a subsidiary thereof; or (3) the customer shall not obtain credit, property, or service from a competitor of the bank, bank holding company, or subsidiary thereof. One of the principal sponsors of this anti-tying provision, Senator Brooke, said its purpose was "to eliminate anticompetitive practices which require bank customers to accept or provide some other service or product or refrain from dealing with other parties in order to obtain the bank product or service they desire." Basically, section 106 prohibits traditional tie-in sales, reciprocal selling arrangements, and exclusive dealing arrangements.

The Bundling of Financial Services

There are some exceptions from the prohibitions in section 106. Four so-called traditional banking practices are excluded from the prohibition on a bank offering a product or service on the condition that the customer either obtain from, or provide to, the bank another product or service. These four traditional banking services are loans, discounts, deposits, or trust services. This exclusion applies only to banks, not to products or services obtained from, or provided to, a bank holding company or non-bank subsidiary. Furthermore, to qualify for the exception, both the tying and tied product or service must be traditional banking practices. With respect to the prohibition against exclusive dealing -- i.e., a condition that the customer not obtain some product or service from a competitor -- there is also an exception where the condition is reasonably imposed in a credit transaction to assure the soundness of a credit.

These exceptions are limited and, in any event, are not applicable to products and services supplied by bank holding company non-bank subsidiaries. Since the Administration's proposed legislation requires new services to be offered by such subsidiaries, Section 106 would be applicable to such new services. Furthermore, these exceptions remain subject to treble damage awards under the antitrust laws since section 106 is not an exclusive remedy for tie-in cases involving banks.

In the 1970 Amendments, the Congress provided a remedy for tie-ins involving banks which was apparently unique. This remedy went beyond the antitrust laws by, in effect, doing away with the need to prove either market power in the tying product or that a substantial amount of interstate commerce is involved. According to Senator Brooke, tie-ins are illegal under section 106 "where either express or implied coercion is involved."

Section 106 only applies where the tying entity is a product or service offered by a bank. However, the prohibitions in section 106 have been extended to products and services offered by bank holding companies and their non-bank subsidiaries in regulations of the Federal Reserve Board (12 CFR 225.4 (c)). With the passage of the Garn-St. Germain Depository Institutions Act of 1982, federally chartered savings and loans and savings banks are now subject to provisions similar to section 106. All federally insured credit unions and savings and loans are subject to some restrictions in the use of tie-ins by regulation.

While the Attorney General has authority to sue to prevent violations of section 106, apparently no such suits have ever been undertaken. However, any party "injured in his business or property" by a violation of the section may sue for treble damages and attorney's fees. Parties eligible to sue would thus include both customers and competitors. Furthermore, any party may sue for injunctive relief against threatened loss or damage from a violation of the section.

There have, in fact, been a number of cases in which private parties alleged violations of section 106 in court actions involving banks. In many of these cases, courts have held that the allegations involved traditional banking practices -- generally requirements to protect the recoverability of a loan; and therefore ruled in the banks' favor. However, the ability of a bank customer to use successfully section 106 is amply demonstrated by the decision in Costner v. Blount National Bank of Maryville, 578 F.2d 1192 (1978). In that case, the plaintiff had obtained a personal loan from the defendant bank to acquire the remaining stock in his automobile dealership. The loan agreement required that the dealership sell a substantial share of its automobile installment paper to the bank. The court ruled this requirement to be a violation of section 106 and awarded the plaintiff treble damages. The court noted that the evidence of economic power on the part of the bank was weak, but stated that under section 106 there was no necessity to prove economic power. (See also Sterling Coal Co., Inc. v.United American Bank in Knoxville, 470F. Supp.964 (E.D. Tenn. 1979), wherein the court held that the plaintiff was entitled to prove its case under section 106 on plaintiff's allegations that the bank required utilization of the bank's legal counsel and an exclusive sales agreement and prohibited the utilization of other banks).

In summary, section 106 provides a powerful remedy for those harmed by the tying of products and services by banks. Such tie-ins are per se illegal without the necessity of showing bank market power or a significant effect on interstate commerce. Treble damages and injunctive relief are provided. Nevertheless competitors and potential competitors of bank holding companies have argued that the effectiveness of section 106 is limited because often the amounts involved are too small to justify a court action. In the first place, this argument ignores the potential for class actions. Furthermore, the Administration has included in its proposed legislation a provision permitting trade associations to sue on behalf of their membership for violations of section 106.

IV. THE ECONOMICS OF BUNDLING BY BANKING ORGANIZATIONS

As discussed in Section II, two circumstances may lead to inappropriate bundling -- market power and inadequate consumer information. In Section III it was shown that the often cited charge that banks have market power over the extension of credit sufficient to force purchase of tied products and services is simply not true. There it was also noted that Congress has also provided a strict prohibition on tying by banks. Thus both competitive markets and particularly strict legal prohibitions are already at work to prevent inappropriate bundling of financial services by banking organizations.[10]

Problems relating to inadequate consumer information, if any, can and should be dealt with directly by consumer protection measures. Senator Garn, for example, has placed in his new bill broad consumer protection powers (Section 107 of S. 2181) with respect to insurance sold in connection with an extension of credit by banks. Such an approach was taken by Congress in dealing with another classic bundling situation -- real estate settlement.

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[10] To single out banks and bank affiliates from other lending organizations for prohibitions based on the potential for tying also cannot be justified. Many other types of organizations supply credit of various types -- often in total amounts equivalent to or larger than that supplied by banks. Any prohibition based on an assumption of market power over credit extension should apply to these other organizations as well.

The use of flat prohibitions against the offering of products and services, cannot be justified when other, less drastic, legal and economic remedies are available. Such prohibitions impose a real loss on the consumers of these products and services. This "lost opportunity" is difficult to quantify, precisely because it is lost. It is nonetheless very real.

For example, one characteristic of banking transactions which distinguishes them from other transactions is that the part of the cost of the transaction borne by the consumer is large relative to the part borne by the bank.[11] This difference is accounted for by the time it takes the consumer to complete the transaction: verifying the bill, writing the check, going to the bank, waiting in line, and reconciling the checkbook. A bank that increases its costs in order to provide an improvement to save the customer's time may well be lowering the total cost of its product to the consumer. And one stop financial shopping, particularly shopping of the routine kind, may well result in significant benefits to consumers.

The restrictions on product offerings by banking organizations severely retard the marketplace development of these possibilities. Undoubtedly, banking would be more convenient and efficient for consumers if these restrictions were removed. The precise constellation of successful future bundles is impossible to predict. That can only be worked out by the dynamic developments in the marketplace. Some bundles will be successes and some will be failures, but certainly the process will winnow out the failures and reinforce the successes.

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[11] See William F. Baxter, Paul H. Cootner, and Kenneth E. Scott, Retail Banking in the Electronic Age: the Law and Economics of Electronic Funds Transfer, 1977, chapter 2.

For non-routine transactions, such as buying real estate settlement procedures or major insurance policies, there are other important reasons for removing restrictions on bundling. They deal, as we said above, with the economics of retailing, with consumers turning over to banking organizations -- or to other vendors, as they choose -- the task of shopping for them. The incentive for banking organizations to offer proper bundles to their customers is very strong indeed, for the very reason that they want to keep their customers .

Banking organizations are manufacturing entities as well as retailers. They bring a collection of inputs-- space, labor, and equipment-- together and produce goods and services. In these production processes, as in most others, there are important economies of scale and scope to be dealt with.[12] Taking full advantage of those economies will often require some form of bundling. When that bundling is done, costs of banking and also costs of the bundled services will be lower. Just as higher costs would certainly be borne by consumers, so would cost reductions redound to the benefit of consumers. Some examples of those potential economies follow.

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[12] The economics of multiproduct firms, especially the useful concept of economy of scope, is carefully developed in William J. Baumol, John C. Panzar, and Robert D. Willig, Contestable Markets and the Theory of Industry Structure, New York, 1982.

A widespread example found in all industries, including banking, is unused capacity. The proliferation of bank branches -- bricks and mortar-- was a marketing response to limitations on interest paid on deposits. Since banks could not attempt to attract deposits by raising interest rates, they did the next best thing which was to provide more branches in the hope of being the most convenient bank for more customers. Now that the regulatory restraints on interest on deposits are reduced, banks often find themselves with more branches than are appropriate or necessary. In some parts of the country banks are being forced to close branches because of their cost. In that context, the sharing of space with real estate, travel agency, insurance, or other similar businesses might reduce costs and allow more branches and hence more convenience to consumers than would otherwise be possible.

Another example of economies from putting unused capacity to work is computers. Computers bought by banks are very similar to computers bought by others: they are general purpose machines. Very often there have been economies of scale in computing so that it is rational to buy a larger capability than is needed at the time. When that is the case, excess capacity, whether held by banks or by others, should be made available in the marketplace rather than left idle.

The Bundling of Financial Services

Banking organizations develop skills and efficiencies in the course of their banking business that are transferable to other businesses. Computer processing is a good example. It would not be surprising if banking organizations were able to be competitive in providing payroll computing services, for example.

One of the least understood, though most expensive and important, parts of the financial services industry is marketing. For example, selling and marketing costs of title insurance and of settlement lawyering when sold alone are very high. If these services were bundled with banking they would add very little to the bank's marketing costs, and could be distributed to end-users in a more convenient and less costly way.

If there were more bundling there would be fewer "sales" costs: the getting to know the client, the matching of sales style to buyer's style, the developing of a professional relationship within which the sale can take place. Similarly, the total amount of effort expended in reviewing, say, a real estate transaction can probably be reduced; and through delegation to clerical staff at an earlier stage, the cost of the review can be reduced. Thus, if bank holding companies were able to provide property insurance, after the bundled sale had been made by the bank, there would be no need for the insurance staff to review all details of the transaction other than those uniquely related to potential perils. They could rely on the bank for review of creditworthiness or market value of the house.

In summary, numerous opportunities for savings for consumers, in both time and money, can be realized by allowing banking organizations to offer additional goods and services. Two examples -- real estate services and insurance -- illustrate the opportunities for cost savings.

Residential real estate purchase transactions are typically extremely expensive. Something on the order of 10 to 11 per cent of the cost of the average house arises from the cost of the transaction: the brokerage fee, the mortgage origination fee, the legal fees, the title insurance costs, and the other miscellaneous closing costs.[13] Students of these transactions have difficulty explaining such remarkably high costs. Any significant reduction of those costs could provide major public benefits, not only by saving consumers money on the transaction, but also by improving the efficiency of the real estate market and by taking better advantage of the housing stock.

Allowing banking organizations, as well as other providers, to bundle more of the transaction together could increase competition and lower costs. As with department stores, banking organizations have a strong incentive to provide appropriate and efficient settlement services because if customers are dissatisfied with one part of the relationship, they can take all their business elsewhere. If a customer buys these services directly from specialized firms and he is dissatisfied, his only recourse comes when he reenters that narrow specialized market.

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[13] See Department of Housing and Urban Development, _RESPA: The Real Estate Settlement Procedures Act, Section 14a: The 1979-80 Evaluation_, October 1980, especially Vol. I, p. 3.2

Such limited recourse by consumers dilutes market discipline for ineffective or inefficient firms.

Segments of the real estate industry, not surprisingly, oppose the entry of banking organizations. Their arguments concerning the ability of banking organizations to tie the real estate services to the extension of the mortgage loans are not supported by the facts. Banks do not have the market power over mortgage lending that would be needed to impose such tie-ins.[14] Furthermore, savings and loan organizations, which have a larger percentage of the mortgage market, are generally able to offer such real estate services.

Insurance, like residential real estate, is characterized by high transactions costs. These costs reflect ineffective price competition and high marketing and distribution costs. Both the freedom from antitrust scrutiny provided by the McCarren-Ferguson Act and regulation contribute to ineffective competition in insurance.

The insurance industry has been undergoing fundamental change as direct writers like Allstate and State Farm capture an increasing share of the market with their lower cost delivery systems. Nonetheless, complex information hurdles make it difficult for insurance buyers to compare policy terms and costs. It is in precisely such situations that consumers would welcome the opportunity to buy financial services as part of a larger relationship in which they have more control and where the seller's incentive to provide the best service is especially strong.

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[14] See Figures 1 and 2 and the accompanying text.

V. SUMMARY

Bundling of products and services is a pervasive phenomenon. Bundling provides important benefits to consumers of all types of goods and services, benefits of lower prices and greater convenience. Obvious examples are found in the development of department stores and supermarkets. It is against the background of pervasive and beneficial bundling that the potential for tie-ins in the offering of financial services by bank holding companies should be considered.

The most appropriate bundles of financial services will vary over time with changes in technology and consumer preferences. Given the current rapid pace of change on both fronts, the potential benefits of flexibility in bundling financial services by bank holding companies are especially great. Two good examples are the areas of real estate settlement services and insurance -- both of which are currently marked by high transaction costs.

In general, market forces can be relied on to determine which bundles are appropriate and which are not. However, markets may not function properly where a seller has monopoly power over a product or where information problems prevent consumers from properly judging the bundles of goods and services available. In these cases, government intervention may be appropriate. Such action can take one of several forms:

outright prohibition of bundling, prevention of abuses through general antitrust and consumer protection laws, or targeted antitrust and consumer protection laws aimed at specific areas of abuse. Outright prohibition of bundling should be avoided if possible, because it will almost always result in hidden costs to consumers in the form of lost opportunities for lower costs and greater convenience.

It is often alleged that banks have monopoly power over the extension of credit sufficient to justify an outright prohibition on the offering of certain related services. These allegations are demonstrably false. The market for credit is highly competitive, and banks provide only about one-fourth of total credit in the economy. It is only in short term lending to corporations that they account for more than half of the total market.

Data from applications submitted to the Federal Reserve Board seeking approval of the acquisition of finance companies indicate that even local markets for consumer loans have large numbers of competitors. Even if there were monopoly problems in the extension of bank credit, a specific provision of exisiting laws already singles banks out for special treatment. Section 106 of the 1970 Amendments to the Bank Holding Company Act, which is stronger than the antitrust laws, provides a general prohibition on tie-ins by banking institutions and provides for treble damages to injured parties.

Problems with respect to consumer information can and should be dealt with through consumer protection provisions such as those contained in Senator Garn's bill, S. 2181.

The **CHAIRMAN**. Thank you, Mr. Nicholson.
Mr. Pistor.

STATEMENT OF CHARLES PISTOR, CHAIRMAN OF THE BOARD, REPUBLICBANK, DALLAS, TEX; PAST CHAIRMAN, GOVERNMENT RELATIONS, ASSOCIATION OF RESERVE CITY BANKERS

[The complete statement follows:]

Mr. Chairman and members of the Committee, I am Charles Pistor, Chairman of the Board of RepublicBank Dallas. I appear here today as the immediate past Chairman of the Government Relations Committee of the Association of Reserve City Bankers.

The Association of Reserve City Bankers is an association of 400 banking executives representing about 160 of the nation's major banking institutions. Those institutions are located in 35 states and the District of Columbia. The members of the Association represent a large number of regional institutions, some with deposits of $500 million or less, as well as the nation's largest banking institutions.

Although the Association of Reserve City Bankers has been in existence since 1912, it has not often availed itself of the opportunity to present its views before committees of the United States Congress. We are doing so at this time, however, because the issues being considered by this Committee are critically important to the future of the financial services industry. In addition, we requested an opportunity to appear before the Committee at this time to underscore our support for the widespread agreement which exists among banking institutions of all sizes for updating our nation's banking laws and promoting fair and equitable competition in the financial services industry.

I am impressed, as I hope you are, with the unanimity which exists within the banking industry as represented by the various banking organizations here this morning. That unanimity reflects a widespread interest in allowing banking institutions the opportunity to compete in meeting the financial needs of the public. It also reflects the widespread concern over the untidiness which exists today in the financial services industry.

The Financial Services Industry

As you know, many nonbanking companies have entered into the business of traditional banking, and others will undoubtedly do so in the future. Existing law allows those companies to offer both banking and other financial services to the public while not allowing banking the same opportunity.

As a result of all this, banking institutions are seeking new and innovative ways to offer financial services to the public. But, as one member of our Association, Willard Butcher, Chairman of Chase Manhattan Bank, noted in the *New York Times* last year, existing laws and regulations are forcing commercial banks "into convoluted circumventions just to reach their natural customer base."

The overriding force behind this turn of events is the need to meet the financial requirements of an increasingly sophisticated public in today's modern society. What it indicates is that the public is seeking access to a broad array of financial services in a convenient form and at the lowest cost possible. What the public deserves is a public policy that fosters a competitive environment in which those needs can be met.

John Naisbitt, in his best-selling book Megatrends, points out that:

> There are cities and companies, unions and political parties, in this country that are like dinosaurs waiting for the weather to change. The weather is not going to change. The very ground is shifting beneath us. And what is called for is nothing less than all of us reconceptualizing our roles.

He goes on to ask the question "What Business Are Banks In?" The answer we and others would give is the financial services industry. But, we all know that industry is being changed today by technological and market forces beyond our control. Yet, outdated and unjustified laws and regulations continue to prevent the banking industry from adjusting to changes in the financial marketplace and from participating fully and fairly in the financial services industry.

But, this is an issue that goes beyond the question of who is going to be able to do what in the financial services industry of the future. Those same laws and regulations are insulating sectors of the financial services industry against the competitive standards under which we expect other business entities in our society to operate. More importantly, they are denying the public the benefits which would flow out of vigorous competition. As another member of our Association, Walter B. Wriston, Chairman of Citicorp, has pointed out:

> Some people still believe there's a divine dispensation that their markets are theirs--and no one else's--now and forevermore. It is an old dream that dies hard, yet no businessman in a free society can control a market when the customers decide to go somewhere else. All the king's horses and all the king's men are helpless in the face of a better product.

For those reasons, the Association of Reserve City Bankers applauds the efforts of the Committee to address these issues. The Association is particularly encouraged by the initiatives put forward in Chairman Garn's proposed "Financial Services Competitive Equity Act" (S. 2181) and Senator Proxmire's proposed "Depository Institutions Holding Company Act" (S. 2134). Both of these bills build off of the Administration's earlier proposal, the "Financial Institutions Deregulation Act" (S. 1609).

I intend to focus the remainder of my statement on the elements of public policy in these proposals which the Association of Reserve City Bankers believes would allow the public to be better served by the financial services industry in the future.

Products and Services

The Association supports the various provisions in S. 2181 which would allow bank holding companies to offer directly or through a separate subsidiary the following services to the public: (1) dealing in and underwriting municipal revenue bonds; (2) sponsoring and managing investment companies and distributing their securities; (3) underwriting and dealing in mortgage-backed securities; (4) insurance underwriting and brokerage; (5) real estate investment, development and brokerage; and (6) other activities determined by the Federal Reserve Board to be of a financial nature. The Association also supports those provisions in that bill which would allow bank holding companies to acquire insured savings and loan associations and engage in any activity permitted so-called multiple savings and loan holding companies.

The bill, of course, contains a number of associated safeguards or limitations which the Committee may feel are necessary in enacting these provisions of S.

2181. In this regard, the Association respectfully requests that the Committee not unduly encumber banking institutions in their ability to compete fairly with other financial entities nor prevent the public from reaping the benefits which increased competition will bring.

The essential point is that existing laws and regulations have the effect of restricting competition in these areas. As a result, the public is clearly the loser. The public will be better served by allowing banking institutions the opportunity to offer the broad array of financial products and services proposed in S. 2181.

Definition of a Bank

The Association supports efforts on the part of the Committee, the Administration and the regulators to redefine the term "bank" under the Bank Holding Company Act. We note, however, that slightly different approaches are taken in S. 2134 and s. 2181 in this matter.

S. 2181 would define a "bank" as an institution which is either an FDIC-insured institution or an institution accepting transaction deposits and engaging in the business of making commercial loans. S. 2181 would exclude from that definition a "consumer bank," which is defined therein as an institution that would otherwise be a bank but does not make commercial loans. The bill also makes an exception from the restrictions on savings and loan holding company activities for "qualified thrift lenders," defined as an institution which has either 25 percent or less of its assets in commercial type loans or 60 percent or more of its assets in residential real estate loans and investments.

While these exceptions are designed to give institutions meeting certain criteria some breathing room from regulation, we are concerned about statutorily carving out new classes of institutions through which nonbank companies can enter directly into the nation's payments system and yet operate outside restrictions applying to bank holding companies. It would be particularly unfortunate if the legislation included the concepts of a "consumer bank" and "qualified thrift lender" without providing existing banking insitutions an opportunity to offer a wider range of new products and services to the public. The result would be the anamolous situation of a nonbanking company owning a "consumer bank" or a "qualified thrift lender" and still being able to engage in a wide range of banking, financial and other activities, while existing banking institutions remain confined to a narrow band of so-called traditional banking services.

Fundamentally, we believe the guiding principle should be that institutions engaged in banking activities should be regulated comparably to banking institutions. For that reason, we believe a more appropriate approach would be to adopt a broader definition of a "bank" such as that proposed in the Administration's proposal and S. 2134--an FDIC-insured institution, an institution eligible for insurance or an institution which accepts transaction accounts and is in the business of making commercial loans.

We recognize, however, that even this approach may not be entirely satisfactory since it excludes thrifts and other institutions. And, in view of the changes now taking place in the financial services industry, an all-encompassing definition of a "bank" may be difficult to achieve. This makes it all the more important that any legislation enacted into law allow banking institutions the opportunity to compete with nonbank companies which engage in the business of banking through a known or unintentional exemption to the Bank Holding Company Act.

Concentration Limitations

We note that S. 2181 would impose certain concentration limitations that would prohibit a bank holding company with more than 0.3 percent of total deposits at all depository institutions from merging or acquiring a non-bank company if it would result in the holding company having more than 25 percent of its capital invested in any one non-bank activity. This provision is obviously intended to deal with the issue of economic concentration, which has often been used as an argument against the elimination of barriers to competition in terms of price, product or geography among financial entities in this country.

It is worth noting at this point that concentration ratios in the banking industry are well below that of other major industries in this country and well below that for banking in other countries. Moreover, we believe the nation's antitrust laws are sufficiently capable of dealing with anti-competitive concentrations of economic power in this country. For that reason, we do not believe the arbitrary concentration limitations contained in S. 2181 are desirable or necessary.

Interstate Banking

With respect to the provisions in S. 2181 and other bills dealing with interstate banking, the Association continues to support a statement of principles adopted in April 1981 in favor of substantially reducing or eliminating geographic restrictions on banking. A copy of that statement of principles is attached.

The Association believes this is an issue which Congress should address in the very near future. However, the Association is divided concerning the limited expansion S. 2181 would appear to accomodate. We, therefore, do not believe the controversial issue of interstate banking should at this time be included in legislation dealing with product deregulation.

Interest on Demand Deposits and Reserves

Finally, we note that the issues of interest on demand deposits and interest on reserves are addressed in S. 2181. The Association strongly supported the deregulation of deposit rate ceilings. The payment of interest on demand deposits is an extension of the deregulation process which has served the public well.

Nonetheless, the prohibition against the payment of interest on demand deposits is a long-standing one. Its removal may prove disruptive, particularly in view of the steps which have already been taken to deregulate rate ceilings on other deposits. If the prohibition against the payment of interest on demand deposits is to be eliminated, it should be coupled with the opportunity for banking to compete in offering the broad range of financial services and products proposed in S. 2181, provisions which allow for the complete deregulation of banking on the asset side of the balance sheet (such as overriding state usury laws) and the payment of interest on all reserves.

The Association supports the payment of interest on reserves held against money market deposit accounts, the so-called super NOW accounts and any new transactions accounts. We believe, however, that interest should be paid on reserves held against all accounts.

The nonpayment of interest on reserves is an implicit tax on all institutions holding reserves at the Federal Reserve. It ultimately means that those institutions cannot pay their depositors what they can earn elsewhere. The payment of interest on reserves would allow banking and other depository institutions to remain competitive with other savings and investment opportunities facing an increasingly rate-conscious public.

Mr. Chairman and members of the Committee, that completes my statement. I will be happy to respond to any questions you may have.

Statement of Principles on Interstate Banking

Adopted by the Board of Directors of the
Association of Reserve City Bankers
April 5, 1981

Geographic restrictions on banking have prevented commercial banks from more fully serving the public. They have insulated financial markets against the rigorous discipline of the marketplace and prevented the public from realizing the benefits of increased competition. These restrictions are outdated, inequitable and detrimental to the long-run health of the U.S. financial system. They have placed commercial banks at a competitive disadvantage relative to other domestic financial institutions and other providers of financial services. They have also contributed to the increased control of U.S. banks in foreign hands and the loss of position and prestige for U.S. banks in worldwide bank standings.

For these reasons the Association of Reserve City Bankers believes that geographic restraints on banks should be substantially reduced or eliminated. In accomplishing this objective, the Association further believes that the following principles should apply:

1. Relaxation of geographic restraints should be achieved primarily by legislative action at the Federal level.
2. Legislation should be drafted in such a way that the consumer will be better served through greater competition among banks, and also between banks and other providers of financial services.
3. Legislation must take cognizance of fast moving developments in the marketplace and in technology, which have already resulted in the *de facto* provision of many banking services on a national basis.
4. Finally, antitrust standards should be reviewed, and changed if necessary, to assure that banks and bank holding companies will be afforded reasonable opportunities to expand both through acquisition and on a de novo basis. In this regard, it must be recognized that increased concentration is not automatically anti-competitive, and that the definition of markets must be broad enough to include all providers of comparable financial services.

The CHAIRMAN. Thank you very much.
Mr. Hammer.

STATEMENT OF FREDERICK S. HAMMER, EXECUTIVE VICE PRESIDENT, CHASE MANHATTAN BANK, N.A., NEW YORK, N.Y.; PAST CHAIRMAN, GOVERNMENT RELATIONS, CHAIRMAN ELECT, CONSUMER BANKERS ASSOCIATION

Mr. HAMMER. Mr. Chairman, I am Fred Hammer and I am here representing the Consumer Bankers Association.

PARITY OF TREATMENT FOR ALL PROVIDERS

Mr. Chairman, in analyzing the legislation before this committee, the CBA has found it essential to adopt a guiding principle against which to evaluate each issue. On the grounds of equity and consumer benefit, we submit that that principle should be parity of treatment among all providers of consumer financial services. Parity in this context means equality of opportunity for all such companies, irrespective of their history or their particular legal structure. This position is offered without any of the traditional excepts that in the past have accompanied similar unequivocal statements.

We recognize that there are imbalances which impose inequities upon banks and other federally insured institutions, and we believe that S. 2181 attempts to rectify them.

A competitive inequity is clearly demonstrated by the limited types of business activities in which depository institutions may engage. S. 2181 helps redress this imbalance by authorizing bank holding companies to engage in securities, insurance, real estate, and other financial activities. The industry's depth of concern on this issue is illustrated by the unified position of my fellow witnesses.

We strongly support the provisions of S. 2181 that would allow bank holding companies to operate, advise, and underwrite shares of mutual funds, as well as underwrite municipal revenue bonds and mortgage backed securities.

Second, we also strongly support the provisions that would deregulate the insurance activities of bank holding companies. The realities of the marketplace have rendered obsolete the traditional argument that insurance and banking should remain separate. We do believe, of course, that antitying provisions should apply equally to all providers of insurance.

By enabling depository institutions to engage in insurance activities, these provisions would establish competitive parity, result in greater convenience and lower costs to consumers through competitive pricing, and provide an incentive to develop new financial products. At the very least, until Congress equalizes the treatment of all financial services companies, CBA endorses State initiatives granting expanded powers to depository institutions, such as the recent recommendations of New York's temporary commission.

Third, we support the expansion of real estate activities for bank holding companies. Other financial services providers such as Sears, some State-chartered banks, and even thrift institutions are permitted to engage in a broad range of real estate activities.

Parity is essential in order to place all banks on an equal competitive footing with each other and with other providers of financial services.

The effort to redefine bank attempts to close the loophole allowing commercial companies to engage in banking while banks are prohibited from providing a broad range of financial activities. We support the redefinition in S. 2181, provided that it specifically excludes trust companies. Further, we could agree with the proposed exceptions to the definition such as the consumer bank only if bank holding companies are granted all the powers proposed in S. 2181 and if such exceptions are free of geographical restrictions. These conditions are necessary if competitive parity is to prevail and if banks are to be able to provide the same range of services on the same nationwide basis as their nondepository competitors.

Expansion of bank powers is the CBA's major concern at this juncture. However, in view of the clear advantages possessed by others, and since it is directly raised in a number of bills before the committee, we must briefly address the issue of geography.

REMOVE ALL GEOGRAPHICAL BARRIERS

We continue to believe that all geographical barriers in the banking industry should be removed as quickly as possible. However, we would support a number of transitional steps to enable adjustment to a completely deregulated environment if the legislation both established a structure for the phaseout of geographical controls and the total elimination of all controls at a specific time.

Of all the legislative proposals now before Congress, only Senator D'Amato's bill, S. 2107, fulfills these criteria. However, we would be able to accept other transitional steps if they also combined these two features. We consider regional agreements unacceptable because they are discriminatory, protectionist, and ultimately anticonsumer. However, we would not object to validation of regional agreements if they are explicitly recognized as transitional steps for an interim period—that is, occurring within a framework which mandates the removal of all geographical restrictions at a specific time. The Rhode Island legislation, which provides for full reciprocity after 2 years, would be a good precedent.

In addition, since regional agreements by definition discriminate against certain banks, in the interest of fairness, the committee should consider an increase in the level of permissible toehold investments in out-of-State banks during the transition period. This would also provide stockholders in these banks with an increased market for their shares. The present 5-percent threshold triggering the Douglas amendment should be raised to at least 10 percent, or even more if it does not represent effective control of the out-of-State bank.

While CBA generally supports title V amendments to the Consumer Leasing Act, parity requires that we ask the committee to enact an amendment to the National Bank Act clarifying the powers of national banks to lease personal property. Currently, leasing by national banks is based on a single court decision and one interpretive ruling of the Comptroller. Thrifts, in contrast, have explicit leasing authority under the Garn-St Germain Act. As a result of this difference, the leasing activities of national banks are subject to unnecessary and inefficient constraints not imposed on other providers. The amendment we request would permit national banks to compete with other lessors and should make leasing more economical and available to consumers.

Title IV of S. 2181 would further equalize competitive opportunities by directing the Federal Reserve to pay interest on reserves held against certain new accounts. We believe that earnings should be paid on all reserves; however, we support title IV because interest on reserves on at least some accounts would mitigate one cost to depository institutions not borne by other providers.

We also support the concept of title VIII, the payment of interest on demand deposits. It is a logical extension of the deregulation process and would provide an opportunity to reach a broader customer base with a competitive product. However, the costs associated with paying interest on demand deposits are potentially very high. Therefore, in order to pay a market rate on such products and still cover their costs, depository institutions need the ability to earn interest on that portion of demand deposit accounts which they cannot invest themselves—their reserves. Consequently, we cannot support passage of this provision without, first, the concurrent enactment of title IV, authorizing the payment of interest on reserves on new accounts; and second, the classification of interest-paying demand deposits as one such new account.

Regarding delayed availability of funds, CBA is concerned that disparate State laws regulating the funds availability policies of depository institutions could have an adverse effect on our national check collection system. Federal legislation might provide an appropriate solution; however, we have some reservations about title VI as written.

S. 2181 attempts to frame a two-pronged approach to delayed availability: First, disclosures to customers on availability policies, which in general we strongly support; and second, a substantive solution to the fundamental flaw in the check collection process, focusing on notification procedures.

We believe that these provisions are inadequate because they fail to address the real problem. Although the forward check collection process is highly automated, the problem lies in the fact that the return process is manual, resulting in a slow and expensive procedure. A comprehensive solution is needed, rather than an additional regulatory scheme which deals with the symptoms rather than the problem. For example, the system would be more efficient if the Federal Reserve handled return items whether or not they were originally presented through the Federal Reserve. CBA would be happy to work with your staff to develop further workable recommendations on this complex subject.

CBA supports title VII which would deregulate State price controls that govern the extension of business, agricultural, and consumer credit by all creditors. The recent, substantial deregulation of financial institutions' liability portfolios dictates the removal of these arbitrarily imposed controls on the price of assets. If financial institutions are to maintain their long-term viability, they must be able to adjust their revenues in response to their cost of funds.

Finally, we are hopeful that S. 2181 will be amended to extend the exceptions to truth-in-lending involving rescissions on open-ended secured credit programs. Many institutions offer such a product, and qualified consumers find it an efficient, low-cost method of purchasing large items on credit. The exception is scheduled to expire on October 1, 1985, and we urge that it be made permanent so that consumers will continue to have convenient access to these home equity lines of credit.

We appreciate having had the opportunity to testify today, and I would be pleased to answer any questions.

[The complete statement follows:]

TESTIMONY OF THE CONSUMER BANKERS ASSOCIATION
BEFORE THE COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS
UNITED STATES SENATE
THE FINANCIAL SERVICES COMPETITIVE EQUITY ACT (S.2181)
AND
THE DEPOSITORY INSTITUTIONS HOLDING COMPANY ACT AMENDMENTS OF 1983 (S.2134)

Presented by Frederick S. Hammer
February 22, 1984

I am Frederick S. Hammer, Executive Vice President of The Chase Manhattan Bank, N.A. and past Chairman of the Government Relations Committee and Chairman-Elect of The Consumer Bankers Association (CBA).(1)

The Consumer Bankers Association appreciates the opportunity to participate in these hearings on S.2181 and S.2134. We have analyzed the issues presented by these bills and have developed specific positions with respect to them. In devising these positions, however, we have found it essential to adopt a fundamental approach, a guiding

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1. The Association is a nonprofit organization founded in October 1919 to provide a voice for the consumer banking industry. Today the membership of the Association consists of more than 600 commercial banks of all sizes that are actively engaged in extending consumer credit. Combined, the members of the Association now hold over 70% of all consumer credit outstanding and over 80% of total consumer deposits held by commercial banks. The membership also includes over 25 thrift organizations.

principle if you will. We believe that this guiding principle must be to assure parity of treatment among all providers of consumer financial services.

During last year's oversight hearings, we testified that this principle is the only sound guide for the deliberations of this Committee this year and in the years to come. We continue to hold that view. Only by using that concept as a touchstone for legislative action will it be possible to move from the current industry structure -- which is artificially fragmented by product and geographic restrictions -- to one that encourages informed market choices. Only by using that concept will it be possible to assure the efficient availability of the wide array of financial services now being sought by consumers.

Many of the problems that our industry faces are the direct result of laws passed in a vastly different time. In an attempt to respond to the tempestuous events of the early 1930s, Congress established a financial regulatory structure that reflected a public policy that government could best decide which areas should be served and which products provided. Without debating the wisdom of that policy, the fact is that subsequent developments in the marketplace have outpaced the pragmatic policies of that unique historic period. We believe that the role of government in regulating financial markets must be reexamined, and that parity must be the key word in structuring new rules that would apply to all who offer similar services.

One of the residual legacies of this historical intervention by government is a framework of restrictions and requirements. Although essentially covering the entire financial services industry when first adopted, it now imposes disparate treatment on an increasingly smaller segment of that industry. As a result of that static regulatory structure and the dynamics of the marketplace, depository institutions are afforded treatment very different from other service providers, depending on their legal structure.

We urge Congress to recognize this disparity and to remedy it. Only by providing equitable treatment is it possible to assure the development of a strong and vital financial services sector.

The Changed Environment -- CBA's Role

In recognition of the changing face of the industry, CBA, at these hearings last year, announced a change in both its membership and its orientation to more appropriately reflect the new financial environment. Consistent with our new direction, we now welcome as full members any federally insured depository institution, and our current membership includes not only banks but also 25 savings and loan associations, mutual savings banks, credit unions and federal savings banks. Full membership is limited to depository institutions that are federally insured, due to the unique problems confronting this element of the integrated industry. We continue to welcome as associate members, however, with full rights of participation, any providers of consumer financial services who wish to join in a collective effort to develop a financial system based on parity.

Opening membership to all of these providers makes it possible to better serve the entire industry and to escape the always spirited but sometimes disruptive intra-industry disputes. This leaves our members free to use their time and energy to develop and deliver consumer financial services rather than to engage in internecine conflicts.

Parity -- Its Meaning In The Consumer Financial Services Industry

It is essential that the new financial industry order be characterized by parity. By that we mean an equality of opportunity for consumer financial service providers of all types, irrespective of history or their particular legal structure. We offer this as our position without any of the traditional "excepts" that have accompanied similarly "unequivocal" statements made by various segments of our industry.

As adopted by CBA's Board of Directors, this Association's charge is to seek

> "parity among all providers of consumer financial products and services, in which such vendors shall receive competitive equality and be subject to the same regulations and statutes so that no competitive advantage or disadvantage exists among them."

We recognize that many will question our willingness to permit competitors to enter what historically have been areas left exclusively to traditional depository institutions. On the contrary, we welcome to our industry new participants who are prepared to compete within an equitable regulatory framework. Though in some respects we might prefer to remain under the protective shroud of the near-monopolistic environment that existed decades ago, we believe that the entrance of these providers will contribute to a stonger and more vital financial services industry.

We believe that the ultimate answer must be a deregulated financial services system that offers its customers services and conveniences that are determined by the market rather than by government regulation.

The Changed Environment -- The New Financial Market

The marketplace is rapidly eroding the tenuous line between banking and commerce. Nondepository entities are purchasing banks or offering bank-like services. Bank holding companies are affiliating with commercial enterprises, though they remain subject to close scrutiny by federal regulators.

The financial services industry is currently involved in a great deal of cross-industry activity. Though banks and their holding companies have taken part in these activities and have made advances, it is clear that they have only been achieved after significant corporate maneuvering and time-consuming and costly regulatory and judicial scrutiny. Even those activities that are permissible under existing statutes remain subject to dispute, thereby unsettling the expansion process and deterring further activities regardless of their economic soundness.

Parity -- Its Absence for Depository Institutions

Nondepository institution service providers clearly place commercial banks and other federally insured depository institutions at a competitive disadvantage. We would not suggest that legislative efforts be undertaken to curb or limit their ability to perform these services. Rather, we would urge that action be taken to enable us to provide similar products on an unlimited geographical basis and be subject to the same rules.

We believe that Congress should address these obsolete and unfair provisions that frustrate the attainment of parity.

This lack of parity is clearly illustrated in the area of product and service differentiation. After five decades of an artificial separation among different types of financial services, we are now past the point at which commercial banks should be free to offer a full array of products determined by market demand. Commercial banks should no longer be prohibited from offering securities services, insurance products, and any other type of products or services that a specific institution determines that it wants to offer.

The pervasive system of constraints on geographical location is another concern. Although the subject of numerous exceptions and evasions -- including national mail and telephone delivery mechanisms, loan production offices and commercial lending activity, all of which effectively avoid these restrictions by careful contrivance -- these anachronistic restrictions must be removed.

Further demonstration of the obsolescence of these limits is provided by the recent activities on the part of many states to permit interstate bank acquisition.

Another example is that only depository institutions are required to maintain sterile reserves with the Federal Reserve System. Although there is a growing debate as to the efficacy of reserves in this regard, they are believed by some to be an important tool of monetary policy. This mechanism, regardless of its role in implementing monetary policy, is paid for exclusively by the federally regulated depository institutions, although, in fact, it is their customers who actually bear that expense.

A failure to address these and similar issues will perpetuate and enlarge the disadvantages now placed upon one class of service providers in a new environment populated by many that offer identical products and services but without these handicaps.

The Changed Environment -- The Need For Congressional Response

Virtually every witness who has appeared before the Committee during the past year has commented on the dramatic changes in the regulatory and competitive landscape that have occurred over the last decade and seem to be accelerating at a rapid pace.

However, mere acknowledgment of the dramatic changes we are witnessing today is of little benefit to a market that is expending untold amounts of resources and energy in an attempt to devise exotic mechanisms through which to evade the existing regulatory structure. Corporate contortions do not boast of any socially or economically redeeming features other than to demonstrate once more that market forces inevitably will stimulate the level of ingenuity necessary to evade federal regulations. Rather, they serve to perpetuate the image of a regulated industry whose various constituent parts careen back and forth from regulator to regulator, seeking to identify the path of least resistance to avert proscriptions that have not been the subject of serious congressional review for the past half century.

In seeking congressional action in response to a changed environment, we have found it difficult to conjure up cogent arguments that could be advanced by those who believe that legislative changes should not at the very least keep up with the realities of the marketplace. Dramatic shifts in the composition and activity of new and changed financial services providers and the clearly adverse impact on certain segments of the industry have all been exhaustively documented. The question that remains is why that evidence is inadequate to move the legislative process.

The answer can be found by looking to the recent past in which banking legislation needed to have as a driving force some form of intra-industry conflict in order to precipitate compromises and virtually assure that major legislation would not move forward unless each segment got its share, but no segment got too much.

For many years, the principal driving force involved the ability of thrift institutions to pay a slightly higher rate of interest on their deposits than that permitted to be paid by commercial banks. That one vehicle, and issues directly related to it, played a significant part in the contour and timing of virtually every major legislative pronouncement affecting depository institutions adopted in the past decade and a half.

The differential debate has simply been out-distanced by the economic events outlined above. Nonetheless, the legacy of the legislative process formed in this context continues to hang over not only these deliberations, but any future legislative developments. CBA believes that it is important to change the approach to legislative action in the financial services area that has characterized -- and all too often subverted -- previous legislative debates.

The Changed Environment -- A Suggested Congressional Approach

In the past, both the industry and Congress have approached the legislative process in the now-familiar pattern of intra-industry squabbles, tinkering with existing constraints, attempting to juggle the interests of an increasingly diverse community of service providers, and undertaking policy formulation on the basis of judgments as to the relative pluses and minuses among affected industry segments, rather than by attempting to fashion a financial system that follows substance.

CBA believes strongly that neither the members of the financial industry nor the consumers they serve can afford this legislative approach any longer. Instead, when evaluating the various titles of S.2181 we would suggest that the following concepts be kept in mind.

First and foremost, as discussed earlier, the guiding principle must be parity -- not just parity when pursuing a particular goal that means that "we" obtain an advantage over "them," but parity that means equal treatment however that may cut on a particular issue.

Second, product, service, and geographic limitations affecting both depository and nondepository institutions should be ended. Activities supported by proven market forces should be encouraged. The entire array of financial service products should be available to all types of providers whenever they believe it is efficient to offer them.

Third, regulatory involvement should be carefully limited to policing the very narrow range of financial activity that affects the deposit function, imposes a danger for the safety and soundness of the banking system, or has a demonstrable impact on monetary policy. This would permit a broad range of services, thus enabling the market to shape the industry with a minimum of protectionist regulatory interference.

Fourth, there should be a revitalization of efforts to identify the appropriate information to be disclosed to the public, information that does not confuse, but rather informs.

Obviously, these are only some of the major principles that must be taken into account. As these principles are identified, however, it is important to recognize that they must be founded on social and economic efficiencies, and not on the imposition of government statutes and regulations that do not balance well on the shifting rock of the American financial experience.

In addition to these efforts at the federal level, Congress should protect and encourage the efforts of several states (for example, the recent recommendation of the New York Commission on Banking, Insurance and Financial Services) that have recognized the realities of the new diversification in the financial services arena. These initiatives range from the abolition of archaic usury laws to the reconsideration of appropriate services on the part of state banks. These laudable efforts have illustrated a new realism and a thrust toward parity that we believe is long overdue.

We strongly believe that a rapid recognition of and adjustment to the new financial environment will free economic forces to engage in productive endeavors. This will be a major step forward in providing reasonably priced and widely available consumer financial services.

DEREGULATION OF BANK PRODUCTS AND SERVICES

Depository institutions have long been subject to quite narrow restrictions on the types of business activities in which they may engage. Though other financial service providers have successfully penetrated traditional "banking" markets by such means as money market funds and cash management accounts, depository institutions have been prevented by the Glass-Steagall Act, from engaging in most types of securities activities, and precluded by the Bank Holding Company Act from undertaking any activities other than those narrowly defined by the Act.

Several legislative proposals have attempted to address the issues of depository institution deregulation. Though the Garn-St Germain Act accomplished much in eliminating distinctions among depository institutions, it only started the process of furthering competition with non-depository entities by authorizing a money market deposit account.

There are two major proposals before the Committee, S.2181 and S.2134. Although these bills contain different approaches with regard to the scope of new powers for bank holding companies, both are based on S.1609, the Administration's proposed Financial Institutions Deregulation Act. They contain a number of similar provisions with regard to expanded securities powers, in such important areas as revenue bond underwriting, mutual investment fund powers, and underwriting of mortgage-backed securities.

However, the differences between these bills are more significant than their similarities. For example, S.2134 does not include expanded insurance powers and real estate brokerage powers. Both of these powers are included in the Administration's bill and have been under discussion for several years. The more expansive view contained in S.2181 is the most workable approach toward total deregulation. As the members of this Committee are aware, Title I of Senator Garn's legislation is strongly supported by the banking industry. CBA concurs and urges the Committee to support these critical provisions in order to provide parity among competing providers of financial services.

DEFINITION OF BANK

Several bills pending before this Committee redefine the term "bank" for purposes of the Bank Holding Company Act (BHCA). Since the BHCA applies to companies that control "banks," its definition determines which companies will be subject to that Act's restrictions on permissible activities. In turn, the limited list of permitted activities for bank holding companies determines the extent and nature of the division between banking and commerce. Thus, the definition of the term "bank" provides the legal mechanism for the separation of banking and general commerce -- a principal objective of the BHCA.

By redefining the term "bank," the bills before this Committee purport to maintain the division between banking and commerce. While the Proxmire bill (S. 2134 Section 2(i)) and the Heinz bill (S. 2071) in large part maintain that separation, S. 2181 does not since it authorizes two new types of institutions, the ownership of which does not subject the parent company to any activity restrictions.

The exemption for consumer banks from the definition of "bank" erodes the barrier between banking and commerce, since any company in any line of commerce may own a consumer bank. If "consumer banks" erode the barrier between banking and commerce, the new "qualified thrift lender" in S. 2181, which also may be owned by any company in any line of commerce, completely removes that barrier. While consumer banks have very limited commercial lending authority -- five percent of their assets may be invested in only small business loans and retail inventory financings -- qualified thrift lenders are permitted to invest up to 25 percent of their assets in any type of commercial lending activity.

In view of the debate on what contitutes a "bank" and the increasingly contrived use of terminology to effect a major policy choice, CBA believes that it is an appropriate time for Congress to reexamine the purposes of the BHCA and the need for a separation between banking and general commerce. If Congress intends to reinstate a rapidly disappearing line between banking and commerce or even move to eliminate that line, we respectfully suggest that the issue should be confronted directly to specifically determine at what point on the spectrum the line should be drawn. Thus, given the structural implications of this "definitional" change, we urge full and deliberative consideration of the continued viability of the limits that constitute the real issue presented here.

We recognize, however, that there might not be time for this Congress to address an issue of such magnitude, so it may elect to maintain the basic structure of the BHCA with its activity restrictions. CBA's position on the "bank" definition, therefore, is based on the premise that Congress intends to maintain a division between banking and general commerce and therefore to maintain the BHCA and its restrictions on bank holding company activities.

Bank Definition Is Linked To Expanded Powers

Since CBA's positions are founded on the basic tenet of parity of treatment, its position on the definition of "bank" depends on the enactment of significantly expanded powers for bank holding companies.

If all new activities ARE authorized. If final legislation provides bank holding companies with _all_ the new activities that are authorized by S. 2181, CBA would not object to the redefinition of "bank" contained in S. 2181, including the proposed "consumer bank" exclusion. We would also not object to the new exclusion contained in the bill for "qualified thrift lenders" as long as the present geographical restrictions are not imposed and as long as the definition includes a specific exemption for trust companies such as the one contained in Senator Proxmire's bill.

If permissible activities for bank holding companies are expanded so that bank holding companies can compete with other financial service providers, there would be no pressing need to eliminate the existing "nonbank bank" option. Although the authorization of consumer banks and qualified thrift lenders would specifically permit companies in nonfinancial lines of commerce to own depository institutions, CBA would not object to the perpetuation of this inequity. We would object, however, if the legislation were amended in any fashion to preclude companies that are currently operating as bank holding companies from spinning-off activities that are impermissible for "consumer banks" or "qualified thrift lenders" in order to avoid the BHCA.

If new activities are NOT authorized. If final legislation does not include all the new activities that are contained in Senator Garn's legislation, we support the redefinition of the term "bank," without the "consumer bank" exclusion that is contained in Senator Garn's legislation. If Congress is not willing to enact major structural reforms that unshackle traditional depository institutions and their parent companies, then Congress must preclude companies that are not similarly constrained from owning depository institutions. In short, we would support a redefinition that closes the "nonbank bank" option and, therefore, would oppose the proposed "consumer bank" as it is now contained in S. 2181. We would also strongly oppose the inclusion of a "qualified thrift lender" exception to the Savings and Loan Holding Company Act.

Specifically, if all the new activities are not authorized, CBA would support a redefinition of "bank" that includes any insured bank and any institution that both accepts deposits that the depositor may withdraw by check or similar means and is engaged in the business of making commercial loans. While we would oppose the "consumer bank" exclusion, we would not object to the continued exclusion for thrift institutions, so long as all companies that own a thrift institution are subject to the activity restrictions of the Savings and Loan Holding Company Act.

CBA also firmly believes that any redefinition of bank must explicitly exclude trust companies. We, therefore, support the provision of Senator Proxmire's bill (S. 2134) that specifically eliminates any institution that functions solely as a trust company from the "bank" definition.

CONCENTRATION LIMIT

Section 104 of Title I of the bill precludes a bank holding company whose subsidiaries' domestic deposits exceed .3 percent of all domestic deposits from acquiring a financial service company if, as a result of that acquisition, it would have an investment in any one of the permissible activities that exceeds 25 percent of the holding company's consolidated capital. Senator Garn has indicated that the effect of this concentration standard is to limit acquisitions of large insurance, real estate, securities, or other financial organizations by approximately 25 of the largest holding companies.

CBA strongly opposes these arbitrary limitations. They would impose a new and unnecessary test that goes far beyond any current concept of undue concentration and monopolistic power. Presumably, this new standard is intended to prevent "undue concentration" and the resulting evils that antitrust policies are designed to condemn -- market control and monopoly pricing.

Under existing antitrust law, concentration is a concept that only has economic meaning and legal significance when applied to a particular market. The proposed standard, however, would operate without any regard to a particular market. Instead, it appears merely to reflect the concept that "big is bad," irrespective of the absence of any undesirable social or economic effects. Thus, this flawed approach goes far beyond any of the tenets of well-tested and longstanding antitrust laws.

Expanding permissible financial services activities for bank holding companies undoubtedly will produce some market adjustments, possibly including marginal increases in concentration in some areas. However, the liberalized entry of banking institutions into other financial service areas and of other financial services providers into traditional banking areas will have a positive competitive impact by requiring all participants to respond to actual and potential competition. Any conceivable anticompetitive effects of higher levels of concentration will be more than offset by the positive competitive contributions of potential and new entrants into both traditional banking and other financial service areas.

The financial services industry is not now concentrated by any conventional definition, and it will not experience undue concentration as a result of the removal of current product barriers, which would merely free competition among all financial service providers. If in fact "undue concentration" in particular market areas should ever become a problem, it can be dealt with through the application of antitrust laws in the same way that undue concentration or predatory practices are addressed today in all industries. The remote possibility of future concentration in the financial services industry simply does not present a sound basis for imposing arbitrary size limitations on the growth of financial service enterprises.

CBA is also concerned by the absence of any clear definition of "domestic deposits". It is unclear whether domestic deposits are those held by domestic banks, those that emanate from domestic sources, or whether the term is to be applied in some other fashion. In addition, while it appears that "all domestic deposits," against which a bank's consolidated deposits are compared, refers to the domestic deposits of all financial institutions and not just those of banks, that is not clear from the legislation. These issues would have to be clarified if any legislation is enacted that includes the concentration limit now contained in S.2181.

Although the proposed new concentration standard may affect only a small number of institutions, it is significant to all of them since it establishes a totally new precedent for governing the maximum size of a corporate entity. Since this provision establishes a standard that applies irrespective of any antitrust evaluation of undue concentration in the specific geographical or product markets in which the bank holding company is operating, CBA strongly opposes it.

SECURITIES ACTIVITIES

CBA strongly supports the expansion of permitted securities activities for depository institutions. In this context we would like to outline briefly, as a predicate, the history and basis of the Glass-Steagall restrictions on bank involvement in securities activities, then discuss more fully the specific types of securities activities in which depository institutions would be permitted to engage under S.2181.

The Glass-Steagall Act was enacted in 1933 in response to very specific circumstances. At that time, in the depths of the Great Depression, it was generally believed that among the causes of the many bank failures was the significant involvement of commercial banks in investment banking through securities affiliates. The purpose of the Glass-Steagall Act was to protect against the hazards that were attributed to the then largely "unregulated" combination of commercial and investment banking. However, the Glass-Steagall Act never established an absolute wall between securities and banking activities, for it did permit banks to engage in various securities activities, such as underwriting general obligation bonds and purchasing and selling securities for the account of bank customers.

Conditions have changed dramatically during the fifty years since Glass-Steagall was enacted. Technological, economic, and market changes have, in effect, turned the Act into an anachronism and a barrier to economic growth. The growing involvement by securities firms in what traditionally has been perceived as banking activities demonstrates the natural affinity of these activities. But the complementary natural growth of depository institutions is thwarted by this outmoded statute. A statutorily imposed artificial wall between securities and banking activities is no longer tenable or desirable in today's business environment.

Municipal Revenue Bonds

CBA believes that the easiest task before this Committee and the Congress is to allow depository institutions to engage in the underwriting of municipal revenue bonds, including industrial development bonds. This proposal has been before Congress many times and has, in fact, been passed by the Senate. It was deleted from the Garn-St Germain Act just before mark-up in this Committee.

Since 1933, banks have been permitted to engage in the underwriting of general obligation bonds. Municipal revenue bonds were an insignificant part of the municipal bond market in 1933, but they have grown to be the largest single segment of that market.

It makes little sense today to prohibit depository institutions from underwriting revenue bonds. This logical extension of bank authority is strongly supported by depository institutions and state and local governments. We support the provisions of S.2181 that would eliminate this historical impediment that prevents depository institutions from offering this service to local governments and the investing public.

There is very little difference between industrial development bonds and municipal revenue bonds, and little increase in risk to the depository institution between underwriting industrial development bonds that are truly for a "public purpose" and underwriting traditional municipal revenue bonds. Therefore, depository institutions should be permitted to underwrite both types of obligations.

Investment Companies

CBA supports the provisions of S.2181 that would allow depository institutions to sponsor, operate, underwrite, and distribute the shares of all types of investment companies. This issue has been fully aired before this Committee on numerous occasions, and enactment of such authority is long overdue.

The pressure on banks to offer services competitive with mutual funds have lessened somewhat since the Garn-St Germain Act authorized the money market deposit account. Banks, however, are still eager to offer the full panoply of mutual fund services, such as tax exempt and corporate bond funds, that other financial service providers can offer to their customers. The ability to offer such funds is a natural complement to the provision of retail deposit and banking services to bank customers.

Since investment companies are separate legal entities, regulated by the Securities and Exchange Commission and registered under the Securities Act of 1933, permitting depository institutions to organize and manage these funds poses little additional risk to the institution or the public. Various existing securities law provisions, especially those in the Investment Company Act restricting affiliate transactions, as well as relevant banking law regulations, would be effective in preventing the types of subtle hazards contemplated by Glass-Steagall.

Allowing depository institutions to sponsor investment companies can only result in public benefit by increasing the number and nature of such funds available to the investing public and by placing depository institutions on a more equal footing with other financial service providers.

Investment Advisory Services

Depository institutions have long offered investment advisory services to their customers, particularly through bank trust departments. The provision of such advisory services is an activity that is "closely related to banking" and authorized for bank holding companies and their subsidiaries. Banks presently provide discretionary management services, act as managing agents for their customers, manage collective investment funds, and advise investment companies. In order to eliminate further litigation and its attendant delays and uncertainties, we support the provisions of S.2181 authorizing the offering of all types of advisory services by depository institutions. This clarification is needed to ensure that the services provided by depository institutions will be fully competitive with the services now being offered by other financial service providers. The absence of any substantial abuses in the present system of offering advisory services by banks is evidence that the well-constructed wall between trust and commercial activities has been effective, and will continue to be so, in avoiding potential Glass-Steagall hazards.

Securities Brokerage

As the members of the Committee are aware, numerous depository institutions have in the last two years begun offering so-called discount securities brokerage services to their customers. Although the manner in which depository institutions offer these services varies, in many instances it is being done on a "joint venture" basis with securities firms. Though provision of these services is clearly permitted under present law, as both the Comptroller of the Currency and the Federal Reserve Board have concluded, litigation is currently pending to prevent depository institutions from offering these services.

The depository institutions that have become involved in the securities brokerage business voluntarily have restricted their activities to discount brokerage services in which they do not offer any investment advice, including making buy or sell recommendations to customers. We believe that as a matter of law, depository institutions are not restricted to such limited brokerage activities, and that they could in fact engage in "full line" brokerage without violating the present strictures of the Glass-Steagall Act. We recognize, however, that in the present competitive environment, litigation will likely ensue if depository institutions proceed in this area without further congressional action. Thus, we would also urge Congress to confirm the authority of depository institutions to engage in full-service brokerage activities.

Other Retail Products

S.2181 would authorize bank holding companies to engage in "activities of a financial nature" and, specifically, to engage in insurance underwriting and brokerage, and real estate development, brokerage and investment.

CBA strongly believes that the authorization of these new activities would provide the public with the benefit of increased competition between bank holding companies and other firms engaged in activities of a financial nature.

INSURANCE POWERS

The Competitive Environment

The competitive position of commercial banks in today's rapidly changing marketplace is threatened by statutory and regulatory constraints that effectively preclude commercial banks from becoming full-scale competitors in the financial services industry. Near-bank entities, such as Sears-Dean Witter, Merrill Lynch, Prudential-Bache, and American Express-Shearson, are not similarly constrained and are busy developing a wide range of innovative financial services to meet the sophisticated needs of customers. Many of the financial products being advertised by these firms bear remarkable functional similarity to services traditionally provided by banks This confluence of traditional banking functions (or their equivalents) and other types of financial services has eliminated the dichotomy between the "banking" and "non-banking" spheres of the financial services business. Competitors are integrating diverse forms of financial services into combined products, not just offering a series of discrete and unrelated products and services through a series of affiliates. One-stop, multiple-product financial centers are being successfully implemented by Sears and other retailers. Unless banks are allowed to perform the same variety of services and ride the wave of change in the financial services industry, they risk becoming economically non-viable as the competition from non-bank firms intensifies.

One of the areas of the financial services market closed to banks, but open to non-bank firms, is the general business of insurance. Leading insurance companies have for some time been positioning themselves to meet customers' demands for comprehensive financial services. Insurance companies, securities firms, retailers and others are leveraging existing customer relationships by expanding into related financial services and cross selling products and services. A partial list of such firms is shown in Table I. Table II illustrates the blurring of product lines between industries.

In spite of the rapid expansion by other industries into the traditional business of banking, some segments of these industries are vehemently objecting to the efforts of banks and savings institutions to offer insurance products. The only logical reason for this objection is fear of competition. However, competition in the financial services market can only result in a wider range of products for the consumer, because the providers will be given the incentive to offer innovative products and improved services at lower prices.

The realities of the marketplace have blurred the outmoded distinctions between providers of financial services, making obsolete the traditional argument that insurance and banking should remain separate. In fact, the similarities between insurance and banking are already more pronounced than the differences. Both are financial intermediaries and both offer similar products.

Unlike those who are trying to impede competition, we do not favor restrictions on these near-bank entities in competing for deposits, loans, and other banking services. To the contrary, we welcome competition, and strongly support the provisions of S.2181 to deregulate the insurance activities of bank holding companies since it will enable all providers of financial services to compete equally.

We oppose the provision that would prohibit banks from indirect solicitation of insurance until the customer has received a written credit approval because neither insurance firms nor savings and loans would be subject to such a restriction. We would suggest as an alternative, however, that banks and savings and loans be required to provide written notification to a customer applying for a secured loan stating that insurance may be purchased from any insurer or an agent of the customer's choice. We respectfully submit that this type of notice as well as the proposed 30-day right of cancellation would more than adequately address the fear that banks will engage in illegal tying practices.

TABLE I

LEVERAGING FINANCIAL SERVICE RELATIONSHIPS

		Products/Major Subsidiaries			
Parent Company	Relationships	Banking	Insurance	Investments	Real Estate
Prudential	Policyholders Investors	Capital City Bank	Prudential	Bache	Prudential Realty
Aetna Life & Casualty	Policyholders	Federated B&T	Aetna	-	-
John Hancock	Policyholders	Buckeye Fin. Corp.	Hancock	-	-
Leucadia National	Policyholders	Amer. Invest. Bank	Charter Nat. Life	-	-
Merrill Lynch	Investors	Merrill Lynch Bank & Trust Co.	Family Life Ins.	Merrill Lynch	Merrill Lynch, Hubbard
E. F. Hutton	Investors	Hutton Trust Co.	E. F. Hutton Ins.	E. F. Hutton	-
American Express	Investors/Cardholders Policyholders	Boston Safe Deposit & Trust	Fireman's Fund IDS	Shearson IDS	Shearson/Amex Mortgage Corp.
Dreyfus	Investors	Dreyfus Bank	-	Dreyfus	-
Sears	Shoppers/Cardholders	Allstate S&L	Allstate Ins.	Dean Witter	Coldwell Banker
J. C. Penney	Shoppers/Cardholders	FNB, Harrington	J. C. Penny Life	-	-
Household International	Customers	Valley N. B. Household Fed. S&L	Alex Hamilton Life	-	-
Beneficial	Customers	Beneficial N. B.	Central Nat. Life, others	-	-
Gulf & Western	Customers	Associates N. B.	Capitol Life Ins.	-	-
AVCO	Customers	Anaheim N. B.	Paul Revere Ins.	-	-
Control Data	Customers	FNB, Wilmington	Gulf Ins, others	-	-
Parker Pen	Customers	First Deposit	First Deposit	-	-

TABLE II

RETAIL FINANCIAL SERVICES MATRIX

PRODUCTS/SERVICES	PROVIDERS	LIFE INSURERS	P&C INSURERS	OTHER INSUR. COS.	COMM. BANKS	THRIFTS	CREDIT UNIONS	FINANCE COS.	T&E CARD	RETAILERS	GAS COMPANIES	MANUFACTURERS	BROKER/DEALERS	INVEST. ADVISORS	REALTORS
Deposit															
Checking					X	X	X	X					X	X	
Savings/Time					X	X	X	X		X					
CD's		X			X	X	X	X		X					
Trav. Cks., Mon.Ord.					X	X	X		X						
CREDIT															
Cards					X	X	X	X	X	X	X		X		
Check Credit					X	X		X							
Auto					X	X	X	X		X		X			
Consumer Goods					X	X	X	X		X		X			
Cash Loans					X	X	X	X							
Student Loans					X	X	X	X							
Personal Loans					X	X	X	X		X					
Retail Accounts										X					
Securities Finance					X					X					
Policy Loans		X													
REAL ESTATE															
First Mortgage		X			X	X	X	X		X					
Home Equity (2nd)					X	X	X	X		X					
Home Improvement					X	X	X	X		X					
Construction Loans		X			X	X									
Owner-occ. Finance		X			X	X	X	X							
Invest. Finance		X			X	X		X							
Second Homes			X		X	X		X							
Brokerage										X					X
Title Insurance				X											
Credit Default Ins.				X									X		
INSURANCE															
Term Life		X	X			X		X	X	X			X		
Whole Life		X				X		X	X	X			X		
Universal Life		X						X							
Credit Life Disab.		X	X		X			X		X	X		X		
Health/Medical		X	X					X	X	X	X				
Auto		X	X					X		X		X			
Homeowners		X	X					X	X	X					
Group		X	X					X	X	X			X		
INVESTMENTS															
Brokerage		X	X		X	X		X	X	X			X	X	
Annuities															
Single Premium		X											X	X	
Periodic Payment		X				X							X		
Group		X													
Variable Life		X							X	X			X	X	
Mutual Funds															
Sec./Commod.		X	X						X	X			X	X	
Money Market		X							X	X			X	X	
Tax Shelters		X			X				X	X			X	X	X
FIDUCIARY/ADVISORY															
IRA/Keogh		X			X	X			X	X			X	X	
Real Estate		X			X									X	
Investment		X			X	X			X	X			X	X	
Cash Management		X			X				X	X			X	X	
Estate/Tax Plans					X	X								X	
Trustee/Executor					X										

Consumer Benefits

Banks and thrift institutions are presently excluded from most aspects of the insurance industry. Without the ability to integrate insurance into the mix of financial services, these institutions are not able to function as a full service entity despite the fact that they have demonstrated their ability to serve the consumer well with an array of complementary financial services. Clearly, the loser is the consumer. The remedy is simple, and well within the public interest. S.2181 would allow banks, thrifts, and insurers to compete by offering similar and complementary financial products which would benefit the public. Passage of this legislation would result in lower costs to the consumer through competitive pricing, provide an incentive to develop new and more valuable financial products, and improve service and make delivery of insurance and banking products more efficient.

Despite the growing variety of new financial accounts, consumers are still dissatisfied because they feel that their demands for improved, more valuable financial services are not being adequately met. For example, many consumers have expressed a need for financial planning and counseling on money management and the optimum use of their financial resources. In one recent survey by SRI International, 86% of U.S. households indicated that one-stop financial services shopping would be advantageous to them because it would provide more competition, convenience, improved information access, better advice, and enhanced funds management.

Consumers look to banking institutions for security and trust in financial services. In a recent survey by the American Council of Life Insurance, "Monitoring Attitudes of the Public", the survey indicated that consumers scored banks higher than both insurers and brokerage firms on such measures as quality of service, privacy, treating people as individuals, reliability, management and trustworthiness. This survey demonstrates that consumers feel more comfortable and secure with their banks, and recognize the importance and value of relationships established over time.

To allow banks, thrifts, and insurers to provide similar products and services poses a number of questions. The most significant, of course, is how the consumer will benefit. Equally important is how consumers will be protected against unconscionable practices. These and other questions can be answered by the experience of the banking industry in comparable areas.

First, banks have had extensive experience in offering insurance to consumers. For example, mutual savings banks in New York and other states have been offering Savings Bank Life Insurance (SBLI) to the public for many years. The SBLI product line has grown to include whole life, term, endowment, limited payment, mortgage protection, senior life, childrens' plans, and family packages. In 1982, there were 1.77 million SBLI policies in force, valued at $13.7 billion. Judging from the consumer response, these insurance policies, which are low in cost and conveniently available through bank branches, are readily understood and accepted.

In recent years, the growth of financial services has given banking institutions the opportunity to demonstrate their ability to develop a range of new consumer-oriented products, services, and financial instruments, including investment and money management services. As the economy changed, depository institutions successfully introduced a vast array of new financial instruments, and applied advanced electronic technology to improve the delivery of financial services.

If banks, thrifts, and insurance companies were permitted to offer a full line of financial products, their costs of delivering these products would be reduced. Insurance agents could offer multiple insurance lines as well as savings and investment products, and banks and thrifts could offer insurance products via bank branches and electronic terminals, at minimal incremental cost, thereby fostering price competition. Most importantly, consumers would benefit by their ability to purchase banking and insurance products, customized to fit individual needs. Furthermore, they would have increased bargaining power to negotiate lower costs and improved service, because there would be a greater number of suppliers to choose from.

Disclosure and fiduciary responsibility have been commonly accepted practices in banking for many years. Truth-in-Lending, Equal Credit Opportunity, Community Reinvestment and Plain English laws significantly enhance consumer education and sensitize financial institutions to community needs. The laws prohibiting redlining, arbitrary practices against specific groups or geographic areas, discriminatory pricing and so forth, can all be carried over to the delivery of insurance services.

The effect of new competition would force the insurance industry to develop new efficiencies of its own, as well as practices that would benefit and protect the public. Insurance would be sold by banks and others under clearly defined principles designed to serve the consumer. These could include the following suggested principles:

- Consumers would be given the widest range of choices among insurance providers. Competition among providers would be encouraged in order to reduce costs and provide better service.
- Consumers would be provided with equal opportunities to obtain insurance. "Redlining" and arbitrary practices in initiating or terminating insurance policies would be eliminated.
- Insurance pricing would be fair and equitable, without rate discrimination.
- Full disclosure of prices, coverage, and other terms and conditions in insurance contracts would be provided to consumers so that they may make informed decisions.
- Insurance contracts would be written in clear, understandable language.
- Legitimate claims would be expedited, and no claims would be unnecessarily delayed or denied.

- Consumers would be better protected, by competition, sound business practices, and regulation, against the possibility of tie-in sales between insurance and consumer loans.
- Consumers would be given the right to cancel credit insurance contracts within a reasonable time period.
- Providers of insurance would be encouraged to publish results of their insurance practices.

In other words, the result of allowing banks and thrifts to become insurance providers would be a better informed consumer, supplied with a wider choice of products by an efficient industry, driven by the powerful forces of competition.

As financial institutions expand their product lines and compete for the customer's business, regulatory changes must keep pace. The existing regulatory authorities can adequately protect the public interest and ensure the safety and soundness of financial institutions.

Banks and insurance companies are already subject to similar regulatory systems. Therefore, regulation of insurance practices of banks and bank holding company subsidiaries can be handled by each state's Insurance Department and banking activities of insurance companies can be regulated by the corresponding Banking Department. These regulators already have the means to deal with bank-insurer affiliations and have the necessary licensing and examination powers to handle actual or potential problems.

Most states have adopted the National Association of Insurance Commissioners' Model Unfair Trade Practices Act which prohibits unfair methods of competition, and unfair or deceptive acts or trade practices. Banking institutions engaged in insurance would be subject to this law just as insurers are today.

Thus, the expertise at the Insurance and Banking Departments will continue to be utilized and the safeguards developed over the years will remain in place. The public will remain protected against unconscionable practices and the safety and soundness of all financial institutions will be maintained. S. 2181 contains the flexibility that will allow depository institutions to meet changing competition and develop innovative products to serve their retail customers. We believe that the regulatory scheme should be flexible enough to enable depository institutions to meet, in a timely fashion, the ongoing challenges they will face in a deregulated environment.

State vs Federal Law

There has been considerable confusion over the January 6, 1984 Federal Reserve Board decision to defer action on the application of several bank holding companies to acquire state-charted banks in South Dakota in order to engage in insurance activites.

Contrary to some reports, the Board did not reject these applications, but rather suspended processing of the applications pending further consideration by Congress of the issues raised by expanded bank holding company powers. The Board decision was also based on its finding that there were "significant legal questions concerning the applicability of the Bank Holding Company Act to state-chartered banks."

It should be noted that the Board did not comment on the issue of whether insurance is "closely related" to banking. In fact, Chairman Paul Volcker has testified before Congress that the Fed supports pending legislation that would permit bank holding companies to engage in insurance activities through separate subsidiaries.

S. 2181 would not preempt state law, but would rather strengthen and make uniform consumer protection provisions with respect to tie-in arrangements. State control and regulation of insurance would be maintained and bank holding companies would only be able to sell insurance where permitted by applicable state law.

There are indications that the Fed is not unequivocally opposed to banks engaging in insurance activities. The Fed on January 10, 1984, only four days after deferment of these applications, approved an application by Citicorp to engage in unrestricted life insurance underwriting in the United Kingdom. This is the first time the Fed has approved a banking organization's unrestricted underwriting of life insurance. Up to this point, the Board's position has been that underwriting life insurance is not closely related to banking. However, in its decision on this application, the Board concluded that the general activity of underwriting life insurance in the United Kingdom was usual in connection with banking or other financial operations.

The Board agreed with the applicant's position that underwriting life insurance in the United Kingdom is financial in nature, because life insurance policies are an important means of savings and are offered as part of a package of consumer financial services. Also, the Board found that the risks to U.S. banking organizations from underwriting life insurance can be adequately managed via prudent underwriting practices.

Recently, the New York State Commission on Banking, Insurance, and Financial Services issued recommendations that would allow depository institutions to engage in a broad range of insurance activities. CBA applauds this effort to bring state law into conformity with the marketplace. Until Congress takes action to equalize the treatment of all financial services companies, CBA endorses the right of states to grant expanded powers to banks and bank holding companies in order to provide competitive parity among all offerors of insurance products.

Arguments Against Expanded Insurance Powers

Opposition to bank entry into the insurance industry has focused principally upon adverse effects on the public interest, namely, decreased and unfair competition; undue concentration of economic resources; improper extension of exclusive franchise monopoly; and conflicts of interest. It has been argued that the combination of credit and insurance, the "tying" argument, would unfairly limit the consumer's ability to choose the best insurance terms and service free from the influence of credit, and would unfairly permit banks to compete against other sellers in the insurance market who have no powers to extend or withhold credit.

These contentions can best be refuted by examining the nature of the banking and insurance industries in order to determine the potential impact of the provision of insurance services by banks on competition in the insurance industry.

Commercial banks in the United States number well over 14,000. Decreasing market concentration among commercial banks at both the local and national levels points to the absence of dominant market power in the banking industry. Yet such market dominance is an absolute prerequisite to engaging in illegal forms of tying practices. Contrary to this argument, a banking charter does not confer upon a bank sufficient market power to engage in tying. Banks still must compete with both banks and other providers of financial services for a market share of the financial services business.

Like banking, the insurance industry has highly competitive pricing, products, and services. Bank entry would not pose an unusual threat to these firms. The adverse effects ascribed to banks' entry into insurance, if any, would equally result from the entry of any other non-bank firms. Bank provision of insurance services will invigorate the market, bringing with it benefits to the customer that always result from competition: lower costs, lower prices, and improved service.

Another major concern is that banks will engage in anti-competitive tying practices in order to monopolize the insurance industry. Tying involves the use of market power in the sale of one product, the "tying product," to coerce customers to purchase some other product, the "tied product." However, the law already provides safeguards. Direct tie-ins are prohibited by Section 106 of the Bank Holding Company Act and are *per se* illegal under Section 3 of the Clayton Act and Section 1 of the Sherman Antitrust Act.

Explicit tie-in arrangements are practically non-existent. However, so-called "voluntary" tying of insurance purchases with bank loans can occur through implicit coercion of customers, which some assert will severely diminish the freedom of consumers to choose insurance coverage best suited to their needs.

There is absolutely no evidence to support allegations of voluntary tying by banks. The potential for any tying arrangement depends upon the existence of market dominance in the tying product. However, in the highly competitive industries of banking and insurance, no specific firm wields such market power. It has been demonstrated that tying arrangements rarely occur in markets where there are a large number of alternative sources of credit.

A recent study done for the American Insurance Association, Expansion of Banks Into Insurance, found that tie-in sales and reverse competition were unlikely to occur in highly competitive markets. The report stated that "deposit-taking institutions generally do not dominate their markets to such an extent that substantial market power could be used to force their way into the markets by compelling the purchase of an insurance product by their depositors." Any attempt by a bank to coerce a customer into making a joint purchase would only result in the customer moving to another bank or credit source. Finally, S.2181 provides a 30-day right of cancellation which will protect consumers from any form of coercion by enabling them to shop for the best rates, coverage, and service.

Under the rubric of decreased and unfair competition, opponents also allege cross-subsidization, predatory pricing, and coercive reciprocity. Such unfair practices, however, require a strong likelihood of eliminating competitors, thus achieving monopoly profits to cover losses from severely underselling. Neither cross-subsidization nor predatory pricing is likely to occur when competitors possess comparable resources or when barriers to entry are so low that new competitors will quickly crop up. Both of these traits are present in the insurance industry. Moreover, predatory pricing is subject to challenge under the antitrust laws.

Coercive reciprocity, in which purchase of one product depends on the sale of another, also requires market dominance to be effective. This practice is prohibited by Section 106 of the Bank Holding Company Act.

The argument that bank entry into insurance will result in "undue concentration of economic resources" is the most specious of all, both as a matter of law and of public policy. This concept has no definition under the antitrust laws, and it is not clear precisely what it means.

It is not likely that undue concentration will result from bank entry into insurance precisely because the banking and insurance industries are themselves so unconcentrated. Banks face competition in almost every aspect of their business, both from other banks and non-bank financial service companies. Yet, no non-bank competitor is prohibited from selling insurance because of fears of undue concentration of economic resources. Banks should be similarly allowed to offer insurance services subject to the alternative legal mechanism of the antitrust laws, thus adding a healthy, competitive stimulus to the market.

Opponents' arguments against allowing banks to engage in insurance can be reduced to a single premise, namely, that granting banks the power to offer insurance services would somehow be an improper extension of bank "monopoly" power. This assertion is clearly flawed.

As we have noted, the banking industry is unconcentrated and competitive. Banks face intense competition not only from other bank entities, but from non-bank businesses that are far less regulated than banks. Furthermore, insurance providers, while highly regulated at the state level, themselves grant credit through affiliates, much as banks do, and they are subject to the same risk of conflicts of interest.

The banking and insurance industries are thoroughly regulated, both by agencies of the government and by the competitive environment that characterize these two industries. These factors should provide more than adequate assurances for those who fear that bank entry into insurance will adversely affect the public interest. The presence of banks in the insurance industry will provide consumers with alternative sources for their insurance needs, adding to their convenience, reducing their costs or otherwise creating benefits from competitive marketing.

REAL ESTATE ACTIVITIES

CBA strongly believes that its members should be allowed to participate in real estate investment, development, and brokerage activities. Real estate activities are a natural adjunct of the retail banking services already provided by our members, particularly mortgage and home improvement loans. In many instances banks presently engage in real estate related activities, for instance in work-out situations and as an accommodation for existing customers. Banks have developed substantial expertise in evaluating and appraising real estate, and have extensive knowledge of all types of real estate markets. These present activities have caused no adverse impact on the "safety and soundness" of banking institutions, and bank customers would be well-served by a comprehensive product line available from banks that have traditionally enjoyed their trust.

Many non-depository financial institutions presently engage in these activities, and at least one financial services conglomerate includes an active depository institution and real estate brokerage components. In order to achieve full and free competition, banks must also be permitted to engage in these activities.

State legislatures have begun to broaden the permitted activities for state-chartered financial institutions. For example, in California, state-chartered savings and loan associations are permitted to engage in the widest variety of real estate activities, including joint ventures. The savings and loans may also, through affiliate corporations, engage in the brokerage, escrow, construction, and marketing business. The banks in California have not been so fortunate. Any bank may invest up to ten percent of its total assets in a subsidiary that is empowered to subdivide, develop, build residential and commercial improvements on, own, rent, lease, manage, operate for income and sell real property, including the ability to joint venture. Due to the current positions of the Federal Reserve Board and the Comptroller of the Currency, neither state-chartered member banks nor national banking associations doing business in California may exercise the same powers.

CBA supports the provisions of S.2181 that would permit bank holding companies to engage in real estate activities. However, we urge the Committee to expand these activities in order to provide banks with sufficient competitive powers. Parity is required in order to place all banks on a competitive footing with respect to each other and with other types of financial institutions. In light of the growing inequity, all banks should have the statutory ability to purchase, own, operate for income, develop, subdivide, engage in construction, manage, rent, lease, market, and act as a broker with respect to real property, including the ability to joint venture in any such activities.

OTHER ACTIVITIES OF A FINANCIAL NATURE

The authority to engage in general financial activities is one of the most important deregulatory provisions of S.2181. It is impossible to predict with any degree of certainty what types of financial services and products will be offered in the future to meet the demands of an evolving economy. S.2181 contains the flexibility that will allow depository institutions to meet changing competition and develop and offer new and innovative products to serve their retail customers. We believe that the regulatory scheme is flexible enough to enable depository institutions to meet, in a timely fashion, the ongoing challenges they will face in a deregulated environment. We also support the provisions of S.2181 and S.2134 to revise the current application procedures required under Section 4(c)(8) of the Bank Holding Company Act and allow a 60-day notice procedure for all "activities of a financial nature."

CONCLUSION

In its efforts to promote true parity among competing providers of financial services, CBA strongly supports deregulating depository institutions and their holding companies. We support giving depository institutions the widest possible flexibility in determining the services and products they wish to offer to their customers consistent with their safe and sound operation. Limiting services which can be offered by depository institutions places such institutions at a clear competitive disadvantage vis-a-vis other providers of financial services. These limitations can only continue to work to the detriment of the public. We believe that S.2181 meets the objective of parity of treatment in the provision of financial products and services.

GEOGRAPHY

The statutory structure that governs commercial bank operations must be conformed to market realities. In the long run, this means that all geographical barriers restricting depository institutions must be removed. That is the only way to assure consumers a full range of competitively priced credit and liability products, to assure fairness among all financial service providers, and to permit delivery approaches and systems that are shaped by competitive market forces rather than by artificial government fiat.

Congress must begin to consider elimination of geographical barriers by providing a specific timetable for the phase-out of geographical restrictions. An efficient and orderly transition from a regulated to a market-oriented environment calls for legislation setting forth a transitional scheme and containing a specific date for total and complete deregulation.

The bill introduced by Senator D'Amato (S. 2107), which contains the essential elements for an orderly transition, might be an appropriate vehicle to begin this discussion. While CBA favors the concepts found in S.2107, we have no objection to transitional steps that differ from those set forth in Senator D'Amato's legislation. However, any legislation establishing transitional steps for geographical deregulation must also provide for the ultimate elimination of all barriers. A number of interim steps might be viable transitional options, including:

- Congressional validation of regional compacts. CBA cannot support this approach unless the validation expires after two, or at the most three, years and the legislation also provides for the elimination or phase-out of all geographical restrictions.

- Authorization of consumer banks. CBA does not object to this approach so long as geographical restrictions are not imposed on the ownership of consumer banks and parity in the provision of products and services with the firms that own them is provided.

- Authorization of cross-industry acquisitions. CBA supports cross-industry acquisitions, but believes that additional geographical restrictions over and above those that currently apply to holding companies and their subsidiary depository institutions should not be imposed.

- Parity with thrift institutions. CBA believes that commercial banks should be authorized to branch to the same extent as thrift institutions.

- Expanded "toehold" opportunities. CBA supports an increase in the percentage of voting stock in a bank that a bank holding company may acquire without triggering the geographical restrictions of the Douglas Amendment.

- Electronic terminal deployment. CBA believes that unlimited deployment of automated teller machines (ATMs) and other electronic terminals should be authorized for all commercial banks. This would do nothing more than recognize what is occurring in the marketplace.

Rationale For The Removal Of All Geographical Barriers

Geographical restrictions on depository institutions are obsolete, they limit the number and types of financial products available to consumers, and they frustrate the attainment of parity of treatment since other financial service competitors are not similarly constrained. Economic, social, and demographic factors have changed dramatically since current branching restrictions were enacted in 1927 and restrictions were imposed on bank holding companies in 1956.

While other financial service providers and depository institutions are not constrained by the same geographical barriers that apply to the commercial bank system, commercial banks have found various approaches and mechanisms to respond to the needs of a changed marketplace. These devices have evolved irrespective of the geographical barriers imposed by the McFadden Act and the Douglas Amendment.

Many banks and bank holding companies are performing banking and banking-related activities on an interstate basis. Those activities include consumer loan and leasing operations, import/export financing, and general commercial lending activities. Emerging technologies allow banks to provide financial services on an interstate basis through shared electronic systems and other mechanisms, such as retail credit card operations, loan production offices, and Edge Act Corporations.

It is important to emphasize that these interstate financial services are being provided through totally legal channels. These devices are legal by virtue of validating court decisions and, often, specific actions of Congress. For example, the 1970 Bank Holding Company Act amendments authorize bank holding companies to engage in activities that are "closely related to banking" on an interstate basis. Under that authority, bank holding companies operate industrial banks, mortgage companies, and finance companies and provide leasing, factoring, and a vast array of other financial services without regard to artificial geographical boundaries.

However, the Douglas Amendment and the McFadden Act preclude commercial banks from providing these same services directly, on an integrated basis, nationwide. Accordingly, through a complex system of legal maneuvering, service compartmentalization, and multi-entity gamesmanship, commercial banks with adequate resources are able to avoid legally the supposedly inviolate walls of McFadden/Douglas.

Avoidance of those walls, however, has several adverse impacts. First, not all bank entities have the resources to engage in these activities thus limiting the field of competitors. Second, each of these devices produces costs that serve no sound social or economic end. Finally, the combination of added costs and fragmented service produces needless inefficiencies that prevent consumers from using these products and services without paying a "government regulatory" surcharge. While banks and bank holding companies must utilize one or a number of these alternative devices for providing interstate services, quite clearly the direct provision of those same services by the bank itself would be more efficient. Geographical constraints on commercial bank operations, therefore, merely serve to foreclose alternative options that are more desirable and more efficient avenues for the nationwide delivery of financial services.

While the federal government has been extremely reluctant to address interstate banking issues, states have been taking the lead. At present, about fifteen states have enacted some form of interstate banking legislation, and interstate banking bills are pending or are under consideration in numerous other states. However, in virtually all instances, these statutes have imposed conditions and limitations that do not permit true interstate banking.

Although in some substantive areas state action is appropriate and provides an instructive experimental forum, in the case of geographical restrictions state action only produces a new system that by its very nature is fragmented by the ad hoc decisions of the legislatures of the several states. Instead of limiting the provision of banking services by depository institutions along artificial state lines, many of these state enactments merely establish new artificial regional boundaries. In our truly national economy with its national banking system, in which money flows without regard to artificial political boundaries, regional restrictions raise the same problems as state restrictions. Therefore, while state actions have served to highlight the obsolescence of geographical limitations on bank operations, state enactments are not an appropriate _long-range_ answer to the market dislocations that result from those restrictions.

Sound Policy Supports Geographical Deregulation

The provision of financial services without regard to artificial boundaries will advance the goal of developing healthy competition in the financial services industry. In fact, it seems reasonable to assume that existing restrictions on interstate activities serve to defeat that goal by permitting or even encouraging pockets of monopolies or near monopolies.

First, concentration in and of itself is not objectionable. It is only when that concentration becomes anticompetitive -- a result against which a full panoply of antitrust rules is designed to guard -- does concentration become troublesome.

Second, concentration is a concept that only has economic meaning when it is applied to a particular market. The market is considered to be highly concentrated when it is divided among relatively few firms and to be unconcentrated when it is shared by many firms. In order to have any economic meaning, therefore, the term "undue concentration" must first refer to a market in which there are very few competitors.

Since the traditional and primary function of commercial banks is to provide deposit and loan services, the "relevant market" is the market that provides those services. That market includes savings and loans, savings banks, credit unions, and even brokerage firms, as well as finance companies, retailers, factors, and other enterprises that make loans to consumers and commercial enterprises. Thus, to determine if the elimination of geographical barriers will present risks of undue concentration, one must determine whether that market is concentrated now to any significant degree such that the elimination of barriers could create the prospect of "undue concentration."

The market for loan and depository services is highly unconcentrated. The number of depository institutions alone is in range of between 35,000 and 40,000 separate institutions. When other providers of similar services, such as brokerage firms, are factored in, the number is much greater and is increasing all the time.

It is obvious that the existing financial services industry does not even border on being "concentrated" and, therefore, the elimination of geographical barriers as both a practical and a legal matter cannot be said to justify recourse to the spectre of "undue concentration." In fact, just the contrary is true. The elimination of geographical barriers should promote competition and enhance the services that are provided to the public.

Other concerns that the elimination of geographical barriers will signal the end of small banks, thereby lowering the level of service to local communities, and jeopardize the dual banking system also are not borne out by historical experience or logic.

Smaller banks enjoy a number of advantages in terms of established customer relationships and loyalty, convenient location, and knowledge of the local market. These smaller banks should fare well in a deregulated environment. Large scale operations are not likely to produce cost reductions since economies of scale are practically nonexistent in the banking industry. In addition, the evidence simply does not support this conclusion since, in states with unrestricted branching laws, small banks have prospered.

Finally, the removal of geographical barriers should not be detrimental to the dual banking system. Clearly, elimination of the Douglas Amendment would have no effect on the dual banking system since holding companies would continue to have the option of owning state chartered banks, national banks, or both. Also, the removal of branching restrictions that apply to national banks should not have a detrimental effect. Experience indicates that states normally act to provide the same advantages to state chartered institutions as are provided by the federal government to federally chartered institutions. There is no reason that this precedent should be any different in the case of interstate branching. In fact, it is just the reverse in this case, since a number of states have already taken action to eliminate interstate branching barriers.

CBA's Position

Recognizing that any transitional measures will have an uneven and inefficient impact on the financial services industry and the consumers it serves, we believe that any transitional measures should be short in duration. Of paramount importance, however, is that any legislation that establishes transitional measures must also provide for the ultimate, timely elimination of all geographical barriers.

Senator D'Amato's bill (S. 2107). Of all the legislative proposals pending before this Committee, the legislation introduced by Senator D'Amato best reflects CBA's position.

S.2107 phases out the Douglas Amendment over a five-year period. The bill authorizes bank holding companies to acquire one additional bank in each of two states each year during a five-year period. During that time, states may reject the federal provisions and thereby prohibit out-of-state bank holding companies from acquiring banks located in the state. If they do so, however, bank holding companies with banking subsidiaries located in the rejecting state are prohibited from acquiring out-of-state banks. At the end of five years, the bill repeals all geographical restrictions that apply to bank holding companies, including any state rejection provisions.

A direct phase-out would allow bank holding companies to expand on a gradual basis into markets that are determined by business decisions and the marketplace, rather than by government fiat. S.2107 is preferable to any other transitional approach since it permits the industry, rather than state legislatures, to determine relevant market areas and it does not replace small artificial boundaries -- those defined by state -- with broader artificial boundaries -- those defined by region. It also does not discriminate against bank holding companies located in certain states, such as New York, Illinois, Texas and California, that are not likely candidates for inclusion in geographical compacts.

We would like to express two concerns about this legislation. First, we do not support the provision that permits states to "reject" the federal enactment during the five-year phase-out period. That provision authorizes discrimination against bank holding companies located in certain states and perpetuates artificial geographical barriers. It also complicates the transitional period and undermines the commendable objective of providing a smooth, equal, and certain transition for the industry. However, if the "rejection" provision remains in the legislation, it is appropriate to maintain the provision that prohibits bank holding companies located in "rejecting" states from acquiring out-of-state banks.

Second, we believe that Congress should also consider a phase-out of the McFadden Act restrictions that apply to national bank branches and provide a parity provision for state chartered banks. By phasing out only the Douglas Amendment restrictions and not those of the McFadden Act, the legislation discriminates against banks that do not choose to operate under a holding company structure.

Validation of regional compacts. Title X of Senator Garn's bill and a bill introduced by Senator Mattingly (S. 2113) permit interstate branching and acquisitions if authorized by state law. These provisions permit states to act together to enter Constitutionally secure arrangements that authorize banking institutions to operate interstate in specified regional market areas.

CBA does not support this transitional approach in the form in which it exists in the two measures before this Committee. We believe that any legislation adopted should incorporate the concept contained in the Rhode Island interstate banking law -- namely, a regional approach for two, or at most three, years, with unrestricted reciprocity after that time. Moreover, in any event, we cannot accept regional compacts, even as a transitional measure, unless an express repeal of all interstate banking restrictions is included in the same legislation. Therefore, we could support the validation of regional compacts only if it is for no longer than three years and if, at the end of that period, all geographical restrictions are immediately eliminated or phased-out over another, shorter period.

CBA does not prefer this method of phasing out geographical restrictions. Regional compacts tend to balkanize the nation and discriminate against banking institutions located in states that are not included within the purview of any state compact. On the other hand, we favor the transitional aspects of these two measures to the extent that they recognize all forms of bank expansion and not just holding company acquisitions.

Consumer banks. Senator Garn's bill exempts "consumer banks" as defined in the bill from the definition of "bank" in the Bank Holding Company Act (BHCA). "Consumer banks" are banks that are not permitted to engage in commercial lending activities. A company that owns a consumer bank, therefore, is not subject to the BHCA unless it also owns a "bank." Bank holding companies are also permitted to own consumer banks as a permissible 4(c)(8) activity.

We do not support the "consumer bank" concept as reflected in the current version of S. 2181 because it moves the banking industry further away from parity of treatment -- CBA's guiding principle. If, however, a consumer bank alternative without geographical restrictions is offered as another interim step in the ultimate elimination of all geographical restrictions, CBA could support it. Thus, we could support "consumer banks" only if they are not subject to the Douglas-type limitations contained in the current version of the bill and if the same regulatory treatment is provided for all owners of consumer banks.

It is not clear from the language of the bill whether the geographical restrictions apply to all companies that own consumer banks or just bank holding companies. The confusion arises because the restrictions are contained in the BHCA and all companies that own consumer banks are not subject to that Act. If the consumer bank concept and the geographical restrictions that apply to consumer banks are maintained in final legislation, we believe that parity dictates that _all_ companies must be subject to the same geographical limitations and the same regulatory structure.

Also, it is not clear whether the legislation authorizes a bank holding company to own _any_ consumer banks. The language of the bill prohibits any company from owning an "additional consumer bank" except under the specified conditions. Since consumer banks are not currently owned by bank holding companies, it is unclear whether the "additional" language cuts off all opportunities for bank holding companies or whether it permits bank holding companies to acquire one out-of-state consumer bank before the geographical restrictions come into play. While the latter interpretation would mitigate CBA's objections to the consumer bank provisions, we still could not support those provisions since bank holding companies would gain little, if anything, from owning a consumer bank that is subject to geographical limits.

Cross-industry acquisitions. Cross-industry acquisitions provide another viable transitional step toward total geographical deregulation, provided that they are not subject to new geographical restrictions. If authorized and allowed to operate under existing restrictions, a bank holding company could acquire an out-of-state thrift, thus enabling it to operate in one additional state. However, the current proposal would not permit that result.

Title I of Senator Garn's bill authorizes bank holding companies to own shares in thrift institutions. If the acquisition results in control of the thrift institution, then that acquisition -- the first one by the holding company -- is subject to the geographical restrictions of the Douglas Amendment. That means that a bank holding company can only acquire a thrift located in the home state of its bank subsidiaries, unless state law specifically authorizes acquisitions by out-of-state bank holding companies. In addition, the bill subjects the future branching of an acquired thrift institution to the geographical restrictions of the McFadden Act. The bill also authorizes savings and loan holding companies to acquire shares of banks, provided that the acquisition is subject to Douglas-type limitations when it results in control of the bank.

If a holding company were to acquire a thrift institution today, in other than an emergency situation, it would become also a savings and loan holding company. While the first thrift acquired could be located in any state, subsequent acquisitions would be limited since savings and loan holding companies are now prohibited by law from controlling multiple thrift institutions in more than one state.

Therefore, if cross-industry acquisitions are authorized specifically by this legislation and if no new geographical restrictions are applied to those acquisitions, a bank holding company would be able to acquire only one out-of-state thrift institution. The same benefit would accrue in the case of a savings and loan holding company acquisition of a bank. Since a bank holding company would also become a savings and loan holding company as a result of the first thrift acquisition, it would then be prohibited from acquiring additional thrifts in additional states due to the geographical restrictions in the Savings and Loan Holding Company Act.

If cross-industry acquisitions are authorized by this Committee, by virtue of existing law those acquisitions will be limited to institutions located in one additional state. CBA urges that this result not be altered by new restrictions that would ban even the acquisition of the first thrift in another state. New geographical restrictions should not be applied to the control of thrift institutions by bank holding companies.

In addition, we object to these new geographical restrictions because they would not only perpetuate, but exacerbate, the disparate treatment of commercial banks. The geographical restrictions that are imposed on cross-industry acquisitions by S.2181 would authorize savings and loan companies to acquire greater "toehold" interests in out-of-state banks than is available under law to bank holding companies. Existing law prohibits bank holding companies from acquiring more than five percent of the voting shares of any out-of-state bank unless the state specifically authorizes such ownership. In contrast, S.2181 would permit a savings and loan holding company to acquire any interest in a commercial bank that does not constitute control of that bank, without triggering interstate geographical restrictions.

The elimination of the new geographical restrictions that are imposed on cross-industry acquisitions by S.2181 would remedy this disparity. Both bank and savings and loan holding companies would then be able to acquire one out-of-state thrift and bank, respectively. Since the acquiring companies would become both bank and savings and loan holding companies by virtue of that first acquisition, further acquisitions would be subject to the geographical restrictions of the respective holding company acts. That result would achieve parity of treatment in the area of cross-industry acquisitions.

Finally, in keeping with its parity of treatment touchstone, CBA also believes that thrift institutions that are acquired by bank holding companies should not be subject to the branching limitations of the McFadden Act. All thrift institutions should be subject to identical branching laws, irrespective of whether they are owned by a savings and long holding company, a bank holding company, or any other company.

Parity with thrift institutions. A logical first step in providing parity of treatment to commercial banks is to provide them with authority equal to that of thrift institutions. To accomplish that objective, the laws should be amended to provide commercial banks with branching authority equal to thrift institutions.

As noted previously, the Federal Home Loan Bank Board has authorized federally chartered thrift institutions to branch in states that authorize state chartered depository institutions to branch. Some states, such as the state of

Illinois, that limit the branching of commercial banks do not similarly limit the branching of thrift institutions. As a result of these federal and state laws, commercial banks in those states are competitively disadvantaged. That inequity has become more significant since thrift powers have been expanded to include powers and services that were traditionally the sole domain of commercial banks.

We believe that this Committee should take at least the first step in providing geographical parity among all financial service providers by granting commercial banks parity with thrift institutions. Commercial banks, therefore, should be authorized to branch wherever thrift institutions are permitted to branch under federal or state law.

Expansion of "toehold" interests. Another logical transitional step that this Committee may want to consider is an increase in the amount of "toehold" interest that a bank holding company is permitted to have in out-of-state banks. The ability to acquire a higher percentage of voting stock in out-of-state banks without triggering the Douglas Amendment would allow the industry to prepare itself gradually for the ultimate and inevitable elimination of all geographical barriers.

An increase in permissible "toehold" positions would be particularly important if this Committee were to adopt legislation that validates regional compacts. Bank holding companies in states that are not included in any compact will be placed in an untenable position, unless they also are provided with some transitional options, such as increased "toehold" opportunities.

We believe that for purposes of triggering the Douglas Amendment, the existing five percent limit on the acquisition by a bank holding company of voting stock in an out-of-state bank should be raised to ten percent. In addition, bank holding companies should be authorized to acquire more than ten percent of the voting shares of out-of-state banks without triggering the Douglas Amendment, so long as that acquisition does not result in "control" of the out-of-state bank. Control is defined currently as control of 25 percent of the bank's voting stock, the power to elect a majority of bank directors, or a Federal Reserve Board finding that the company exercises a controlling influence over the bank.

In other words, bank holding companies should be permitted to acquire any level of interest in an out-of-state bank without becoming subject to the Douglas Amendment, unless the acquisition results in the company effectively controlling the bank. Whether or not a controlling relationship is established, however, bank holding companies should be permitted to acquire at least ten percent of the voting shares of any out-of-state bank.

Expanded electronic fund transfer capabilities. We would be remiss if we did not raise, once again, the issue of interstate deployment of electronic fund transfer terminals. Banks are disadvantaged vis-a-vis thrift institutions and other financial service providers, and in some states, national banks are disadvantaged vis-a-vis state chartered banks. Under some state laws electronic terminals are not subject to the same geographical constraints that apply to branches or they are subject to no limitations at all. On the other hand, national bank electronic terminals are subject to interstate and intrastate banking restrictions because terminals have been held to be branches under the National Bank Act.

Electronic networks are being utilized on an interstate basis under a legal fiction that permits banks to share electronic facilities but prohibits them from deploying their own in markets where they are not permitted to branch. Market contortions and efficiencies, therefore, would be eliminated by exempting electronic fund transfer facilities from the branching restrictions of the McFadden Act. While that is a very limited step, CBA believes it is important in order to provide parity with other financial institutions and financial service providers.

CONCLUSION

Congress should begin consideration of elimination of geographical barriers or provide a specific structure and timetable for phasing out those barriers. CBA would prefer to see all restrictions removed immediately, but we realize that transitional steps may be necessary in order to provide the industry and the marketplace with time to adjust to a deregulated environment. Therefore, we would not object to certain transitional steps, such as regional compacts that expire after two years and are explicitly linked to the elimination or phase-out of all geographical restrictions; consumer banks that are not subject to geographical restrictions; cross-industry acquisitions that also are not subject to additional geographical restrictions; and expansion of "toehold" interests.

However, we favor the transitional approach reflected in Senator D'Amato's bill, since it provides for a direct phase-out with the total elimination of all restrictions at the end of the phase-out period. That approach injects certainty into the process and permits the industry to plan for the future. At this time, we could support only Senator D'Amato's bill, since none of the other transitional measures provide the one element that is essential for CBA support -- the complete elimination of all geographical barriers at a specified future date.

TITLE IV - COMPETITIVE SAVINGS INCENTIVE ACT OF 1983

CBA strongly urges Congress to enact this provision, which provides for the payment of earnings on reserve balances held against the Money Market Deposit Account (MMDA), the Super NOW account, and any other account authorized after December 1, 1982 pursuant to Section 327 of the Garn-St Germain Depository Institutions Act of 1982, or Sections 203 and 204 of the Depository Institutions Deregulation and Monetary Control Act of 1980 (DIDMA).

Though we believe that earnings should be paid on all reserve balances, the payment of interest on reserve balances held against these accounts would remove one cost for depository institutions not borne by money market funds or other providers of similar services. It would further equalize competitive opportunities among depository institutions and the other entities active in the market, in keeping with CBA's fundamental principle of parity.

Most importantly, if Congress enacts Title VIII of S.2181, a provision that will authorize the payment of interest on demand deposits, it is essential, at the very least, that interest be paid on reserve balances, including those held against the new interest bearing checking account, in order to mitigate the cost effects of Title VIII.

Reserve requirements were established to permit the Federal Reserve System to effectively monitor and control monetary policy. Title I of the DIDMA established mandatory, noninterest-bearing reserve requirements on transaction accounts and nonpersonal time deposits for all depository institutions. Prior to this Act, only members of the FRS were subject to reserve requirements. As a result, the Act provides for a gradual transition to the new requirements. Notwithstanding these phase-in requirements, a twelve percent (12%) reserve is generally required for transaction accounts and a three percent (3%) reserve is required for nonpersonal time deposits. As long as these noninterest-bearing reserve requirements are mandated, depository institutions cannot offer accounts that are fully competitive with those offered by the money market mutual funds (MMMFs).

The MMDA and the Super NOW account were authorized by the Depository Institutions Deregulation Committee (DIDC) in response to congressional concern that depository institutions be permitted to offer accounts that would enable them to compete with MMMFs. Title VIII furthers the congressional interest of parity in this area. It provides for the payment of interest on demand accounts, which effectively provides for corporate checking accounts. We have proposed in today's testimony that this corporate checking account be considered a new account for purposes of payment of interest on reserves. This proposed new account, as well as the Super NOW account, are subject to the twelve percent, mandatory, noninterest-bearing reserve requirement, while the nonpersonal MMDAs are subject to the three percent reserve requirement.

Reserve requirements reduce the yield so that the rate offered is not competitive. The rate penalties caused by the reserve requirements are shown in the following table:

Table

Cost of Funds	Rate Penalty Imposed On Depository Institutions By a 12% Reserve Requirement
6%	81 basis points
7%	95 " "
8%	109 " "
9%	122 " "
10%	136 " "
11%	150 " "
12%	163 " "
13%	177 " "
14%	190 " "
15%	204 " "

A large portion of the money in MMMFs is placed by professional money managers for their clients. Many of these professionals have a fiduciary responsibility to seek the highest yield consonant with safety. As a result, even if a corporate account were authorized by Congress, the twelve percent reserve requirement and its resulting rate penalty would make the account unacceptable to these investors. Further, the non-personal MMDA, which has a three percent reserve requirement may result in an unacceptable yield.

It is ironic that the same Act (DIDMA) that mandated the phase-out of differential rates between banks and thrift institutions effectively created a new differential between all depository institutions and money market funds.

By permitting reserves to serve as tools of monetary control, as well as earning interest, Title IV acknowledges that certain arrangements presently permit reserve balances to serve dual purposes. Though counting vault cash against an institution's reserve requirement does not constitute the earning of a return, it does allow depository institutions to use a percentage of their reserve funds in order to conduct business. The DIDMA permits reserve balances held by certain depository institutions to be used to satisfy liquidity requirements that may be imposed under other provisions of federal or state law. The Act also provides that supplemental reserves may be imposed in specifically described circumstances. Such reserves would earn a return up to the yield on the securities portfolio of the FRS.

Congress decided against paying earnings on reserves in the past for several reasons, including the potential cost to the United States Treasury. Banks that held reserves received free services from the Federal Reserve, a valuable competitive consideration. Today, the Federal Reserve charges members and non-members for its services. Further, payment of earnings on reserves was considered to be out of step with industry practice, since banks were prohibited from paying interest on demand deposits. But the new deposit accounts, similar to demand deposits, pay a market rate of interest. Congress was also reluctant to pay earnings only to banks, but now all depository institutions hold reserves, including thrift institutions.

In his testimony before this Committee on September 13, 1983, Paul A. Volcker, Chairman of the Board of Governors of the Federal Reserve System, estimated that the payment of interest on reserves against Super NOW accounts and non-personal MMDAs, at present interest rates, would produce a net revenue loss of $125 million.

Though there is an impact to Treasury, consumers stand to benefit from the payment of earnings on reserves since they would realize either a higher yield on their deposits or a reduction of rates on loans. The payment of a market rate on a full transaction account would simplify the personal finances of consumers who could place all of their money in one account. Ultimately, the servicing costs on these accounts would be reduced as the consolidation of savings and checking accounts would allow depository institutions to operate more efficiently and with reduced costs.

We also believe that the pass-through of earnings on reserves will increase the pool of reservable funds, since money would be drawn from sources that do not presently carry reserves. For example, the Super NOW account would become more competitive and could be as attractive and successful as the MMDA. As a result, the Federal Reserve can improve its control of the money supply.

Title IV provides the opportunity to phase-in the earnings on reserves in a gradual, non-disruptive manner. Its passage is another step towards the congressional goal of competitive equality in the financial services marketplace.

TITLE V - CONSUMER LEASE AND RENTAL PURCHASE ACT

The Consumer Leasing Act was adopted in 1976 and implemented in March of 1977 to provide disclosures for consumer lease transactions recognized by Congress as an increasingly popular alternative to instalment credit transactions. Initially lease provisions were incorporated into the Truth in Lending Act and Regulation Z, the regulation that implements that Act.

However, when the Truth in Lending Act underwent extensive revision in 1980, Congress decided to postpone suggested revisions to the leasing provisions. As a result, the numerous determinations made by Congress as they related to credit transactions have not yet been reflected in the Consumer Leasing Act. In a non-substantive first step in this process, the Federal Reserve Board reorganized its regulation and placed the leasing provisions in an independent regulation, Regulation M.

This Committee is now considering applying these same simplification and reform policies to consumer leasing. While the current rules have in large part performed their intended role, a number of areas remain in need of attention and revision. Many of these issues would be resolved by legislation drafted by the Federal Reserve Board and presently contained in Title V - Consumer Leases and Rental-Purchase Agreements of S.2181. However, the Board's proposal falls short of the goal of reforming the Consumer Leasing Act in a comprehensive way and of extending to this area the determinations reached by Congress during the simplification of the Truth in Lending Act. The Board itself recognized the likely need for further amendments to its proposal in its transmittal letter to Senator Garn.

Background

Consumer leasing provided by financial institutions tends to be regional in nature, concentrated in large part in the western states and particularly in the state of California. These financial institutions engage almost exclusively in long-term automobile leasing, by either directly leasing cars to consumers and businesses, leasing through holding company affiliates or subsidiaries, or buying leases contracted from automobile dealers or independent leasing companies.

There are two types of automobile leases, distinguished by the consumer's liability at the end of the lease. In an open-end lease, the lessee bears the risk of any depreciation that occurs during the term of the lease, though current law generally limits this risk to the total of three monthly payments. In closed-end leases, the consumer is not liable at the end of the lease for market depreciation that has occurred during the lease term. Though financial institutions have traditionally offered open-end leasing, more and more financial institutions are engaging in closed-end leasing, and we expect that this trend will continue to predominate over the next decade.

A consumer who leases a car is, in an important way, obtaining a different product than a car purchaser. The lessor normally requires little or no downpayment, freeing up capital the consumer would otherwise tie up in a car purchase. A person leasing directly from a bank or from a leasing company subsidiary of a bank holding company merely informs the lessor of the vehicle he or she desires, and the lessor takes care of ordering and obtaining the car. At the end of the lease, the consumer simply returns it to the lessor.

Proposed Changes to Title V

Disclosures for Long-Term Leases. In general, CBA supports Title V as it has moved a long way toward the goal of reducing both the number and complexity of disclosures required by the Consumer Leasing Act. However, it contains disclosures for long-term leases that we believe are contrary to both the principles adopted by Congress in the Truth in Lending reform effort and the objective of providing consumers with meaningful and useable disclosures.

The most difficult problem is presented by the proposed requirement of a "total lease cost" disclosure for long term leases. The total lease cost would be the undiscounted sum of all payments, calculated by adding all initial payments, all periodic payments, and all payments due at the end of the lease term.

The Division of Research and Statistics at the Federal Reserve Board strongly argued that the disclosure be deleted. That division recognized the difficulty and potential for misleading consumers that would stem from the fact that the total cost, calculated in this manner, does not reflect differences in the amount and timing of payments and, therefore, inaccurately represents the consumer's opportunity cost of funds. This disclosure also ignores the role of security deposits, and the available options of including insurance premiums, taxes, or other official fees, in quantifying the true cost of the lease to the consumer. In other words, a lease with a large initial payment, smaller monthly payments, and a large security deposit can result in the same "total lease cost" disclosure as one with small initial payments, larger monthly payments, and a small security deposit. But the second lease may be substantially less expensive than the first, since it encumbers less of the consumer's money over the term of the lease. The total cost disclosure may or may not reflect the cost of insurance and official fees and taxes. As a result, this disclosure can be a misleading approximation of the true cost and will not be particularly useful to the consumer.

The section-by-section analysis accompanying the Board's proposal recognizes this imperfection, but justifies the disclosure on the basis that the other information necessary for the consumer to determine which lease is actually less expensive is given by the other disclosures. We do not believe that a consumer who sees one lease disclosure that says "total lease cost: $4956.85" and another that says "total lease cost: $4841.93" is going to stop to calculate his or her opportunity cost of funds. The fact that the number is a federally-required disclosure will only add to the consumer's assumption that the second lease is less expensive.

At the same time, there is no practical way to provide the consumer with an accurate disclosure reflecting the cost of the lease. This was recognized explicitly by the Board's Division of Research and Statistics, which pointed out that in order to assure truly comparable disclosures a standardized lease structure would have to be imposed on the industry. It was implicitly recognized by the Board itself, which despite the internal criticism of the total lease cost disclosure, did not attempt to devise an alternative method of comparing cost.

We believe consumers are given sufficient information to reach their own conclusions about which lease is best for them. It is a simple task for them to add up the components of the total lease cost. To make it a required disclosure carries with it an implicit statement that the figure represents the true cost of the lease that can be compared with other leases to determine which is the least expensive. As demonstrated by the Board's economists, it does not do so.

The second disclosure problem relates to the required initial disclosure of official fees and taxes payable over the term of the lease assuming that these fees are paid to the lessor. It is difficult to accurately estimate them and the consumer would be better served by a disclosure that stated the current costs with a note that they will be a component of future charges but that the amount may change.

Civil Liability

Under the Consumer Leasing Act, as under the Truth in Lending Act, statutory damages of $100 to $1,000 may be awarded for violations of disclosure and other provisions. Although some form of statutory damages seems firmly entrenched in the consumer credit area, these damage awards in fact involve a radical departure from the normal rule in civil litigation, since they may be awarded without any showing of actual injury or loss to the consumer.

The statutory damage provision resulted in a massive number of lawsuits under the Truth in Lending Act, and when that act was revised in 1980 it was determined that statutory damages should be available only for violations of truly important disclosure or other requirements. Section 130 of the Truth in Lending Act was amended to specify those disclosure terms that were so important for credit shopping, or that played such a key "alert" function, that their violation should give rise to statutory damage liability.

This determination should be made in the Consumer Leasing Act as well. The Board, which historically has held the view that its involvement with civil liability questions would be inappropriate, would continue the current law under the Consumer Leasing Act and permit statutory damages to be awarded for any violation of the Act (excluding only the advertising requirements).

CBA has attempted to delineate those disclosure and other requirements that are of such key importance to consumers that statutory damages may be justified. In doing so, we believe that we have faithfully followed the determinations reached by Congress when it reformed the comparable provisions that apply under Truth in Lending. Under both versions, actual damages, costs, and attorneys' fees would continue to be available to all successful consumers for any violation of the Act.

We propose that statutory damages be available only for the following violations:

- Failure to make disclosures to a primary obligor at or before consummation
- In long term leases, failure properly to disclose
    - initial payments
    - payment schedule
    - liability upon scheduled expiration
    - the special open-end lease disclosures.

- Failure to comply with the substantive protections relating to the three-payment rule and the consumer's appraisal rights.

These provisions are the most important ones to consumers, and statutory damages, if justified at all, are most justified in connection with them. Once again, this suggested resolution merely incorporates the congressional decisions made in the Truth in Lending Simplification and Reform Act.

Although lessors have not yet experienced the flood of litigation associated with the Truth in Lending Act statutory damage provisions, the Consumer Leasing Act provides the same opportunity for abusive and nuisance litigation. Further, as leasing becomes more popular, the lure of statutory damages for minor, technical violations will bring a correspondingly larger number of nuisance suits before the courts. We believe that the limitation on the availability of statutory damages should be an important element of any revision of the Consumer Leasing Act.

Title V departs from the Truth in Lending Act by imposing civil liability for violations of the advertising requirements of the Consumer Leasing Act. To us, it is inappropriate for lessors to be liable for advertising violations when creditors are exempt from the same liability. The advertising provisions are typically enforced under the Truth in Lending Act, at least with respect to financial institutions, in the course of normal examination by state and federal financial institution regulators. The Federal

Trade Commission has authority to enforce the advertising requirements against other creditors and lessors. These mechanisms operate no differently in the leasing area, where the same agencies have the same enforcement authority. There appears to be no reason to invite civil litigation by consumers as well.

Relation to State Laws

A troublesome issue with any federal disclosure statute is the relation between the federal law and any state laws that require disclosures in connection with the same transactions. The current Consumer Leasing Act provisions regarding state laws provide for preemption of "inconsistent" state laws, except where the state law provides greater protection or benefit to consumers.

The Board has interpreted the section in Regulation M to mean that if a lessor can comply with state law without violating federal law, the provision is not preempted.

The result is that lessors in states with state disclosure laws are generally required to make both the state and the federal disclosures, and disclosure statements are complex and redundant.

Title V would make a relatively minor change in the standard by which state laws are determined to be inapplicable. It would eliminate the current law's "greater protection or benefit" standard from the federal preemption provision, but would continue to exempt lessors from state requirements only to the extent that those requirements are inconsistent with federally mandated disclosures. If that standard is interpreted by the Board in the way the identical standard is interpreted under the Truth in Lending Act, the Board would preempt only those state laws that directly contradict federal disclosure provisions. Thus, lessors would still have to comply with federal disclosures _and_ whatever additional disclosures are imposed by state law.

While most states do not have a leasing disclosure law, those that do frequently require many of the same disclosures that are mandated by the present Consumer Leasing Act. A number of the federal disclosures would be eliminated by passage of Title V due to a congressional determination that the marginal information they provide is not offset by the confusion and "information overload" they create. However, the present "inconsistency" standard could permit states to retain most disclosure requirements rendering the congressional determination meaningless. In those states requiring additional disclosures, the methods of disclosure may differ, and consumers in those states will continue to receive disclosures that are confusing and redundant.

In fact, the problem may even be exacerbated because Title V would segregate the federally mandated disclosures into a "federal box" similar to that required under Truth in Lending. When additional terms are required by state law, these would have to be disclosed outside the federal box, thus adding to the length and confusion of the lease documents.

CBA would like to propose a new standard for determining exemption from state law disclosure requirements. Under CBA's proposal, lessors would be exempted from compliance with state disclosure laws that are "comparable" to the specific terms and conditions of consumer leases disclosed under federal law. Under this standard, state laws requiring more disclosures, different disclosures, or more detailed disclosures concerning consumer leases would be preempted.

An exception would be made for those state-required disclosures that relate to specific contractual terms and conditions imposed by state law. For example, a state disclosure provision that requires disclosure of the lessor's warranties would be preempted because it relates to the terms and conditions of a consumer lease disclosure under federal law. However, if the state requires a particular warranty be given, and also requires a disclosure relating to that state-imposed warranty, failure to make that disclosure could lead to liability under the state law.

Adoption of this standard would not result in the wholesale preemption of major state disclosures for leases.

A number of those states that do require disclosure, moreover, adopted their disclosure laws before the enactment of the Consumer Leasing Act. Both the 1969 and the 1974 versions of the Uniform Consumer Credit Code include leasing disclosures, and while they do not explicitly defer to federal law as they do with respect to credit cost disclosures, that should not be read as a state determination in favor of duplicative disclosures. Rather, the lack of a deferral provision is undoubtedly due to the fact that at the time these uniform laws were drafted, there was no federal legislation in the area to which to defer.

Adoption of a broad preemption standard would be beneficial to both consumers and lessors. Consumers would be spared the complex and lengthy disclosures imposed by state requirements and would have their attention properly focused on the key disclosures required by federal law. Lessors would be spared both the expense and administrative burden associated with compliance with both state and federal law, and those operating in more than one state would be able to use one set of forms rather than having to produce separate forms for each state.

The Consumer Leasing Act is an appropriate context in which to experiment with this new preemption standard. The standard would displace the laws of relatively few states. At the same time, it would give Congress an opportunity to examine a different type of preemption provision. Annual reports provided by the Federal Reserve would keep Congress informed of developments in the area, permitting a reassessment of the broader preemption standard if that appears warranted in the future.

Finally, we would note that the Consumer Financial Services Committee of the American Bar Association has had a subcommittee studying this problem for over five years. Recently, that Committee unanimously approved a report calling for the comparability standard to be used as the Truth in Lending preemption criteria. A fuller explanation of this proposal is found in the section of the testimony on Relation to State Law.

To provide this Committee with some indication of how this preemption criteria would operate, CBA has retained the services of Professor Ralph Rohner of the Columbus School of Law at Catholic University to apply the standard against the leasing laws of three states: Washington, Utah, and California. Professor Rohner was the Senate counsel involved with the original Consumer Leasing Act in 1976. In addition, he has written numerous books and articles on consumer credit law and the relationship between federal and state law in this area. Attached as Appendix A of this section are the results of Professor Rohner's study.

CBA would also ask the committee to consider an amendment that would affect a small number of state laws and court decisions that attempt to regulate consumer leases by recharacterizing them as credit sales, loans, or secured transactions. In effect, these state laws subject consumer leases to substantive regulation "through the back door." The difficulty presented by these laws and decisions is that the provisions were designed for very different transactions and make no sense in the context of leasing.

APPENDIX A

Utah Uniform Consumer Credit Code

70B-2-311. Consumer leases. With respect to a consumer lease the lessor shall give to the lessee the following information:

(1) brief description or identification of the goods;	(1) Preempted: § 112(2)
(2) amount of any payment required at the inception of the lease;	(2) Preempted: § 112(3)
(3) amount paid or payable for official fees, registration, certificate of title, or license fees or taxes;	(3) Preempted as to pre-consummation payments: § 112(3)
(4) amount of other charges not included in the periodic payments and a brief description of the charges;	(4) *Not* preempted
(5) brief description of insurance to be provided or paid for by the lessor, including the types and amounts of the coverages;	(5) Preempted: § 112(6)
(6) number of periodic payments, the amount of each payment, the due date of the first payment, the due dates of subsequent payments or interval between payments, and the total amount payable by the lessee;	(6) Preempted: § 112(4)
(7) statement of the conditions under which the lessee may terminate the lease prior to the end of the term; and	(7) *Not* preempted (But cf. § 112(8))
(8) statement of the liabilities the lease imposes upon the lessee at the end of the term.	(8) Preempted: § 112(9) and (10)(B)

California Vehicle Leasing Act
[Civil Code § 2985.8]

§ 2985.8 Lease contract; requirements; contents

Every lease contract shall be in writing and, if printed, shall be in type no smaller than six-point, and shall contain in a single document all of the agreements of the lessor and lessee with respect to the obligations of each party. The contract shall be signed by the lessor or his authorized representative and by the lessee or his authorized representative and an exact copy thereof shall be furnished the lessee by the lessor at the time the lessor and the lessee have signed the contract. No motor vehicle shall be delivered under this chapter until the lessor delivers to the lessee a fully executed copy of the contract. The lessor shall not obtain the signature of the lessee to a contract when it contains blank spaces to be filled in after it has been signed. Every contract shall contain, although not necessarily in the sequence or order set forth below, the following separate items:

(a) A brief description of the motor vehicle, including the identification or license number if known, or both the identification and license number if both are known.

(a) Preempted: § 112(2)

(b) If the lessee is to bear the risk of the motor vehicle's depreciation, the value placed on the motor vehicle at the inception of the lease.

(b) *Not* preempted

(c) The amount of any prepayment made by the lessee at the inception of the lease, other than a security deposit or advance periodic payment, and the monetary value and brief description of any property accepted by the lessor in lieu of cash.

(c) Preempted: § 112(3)

(d) The amount of any advance periodic payment or payments required after the inception of the lease and before the first periodic payment.

(d) Preempted: § 112(3)

(e) The number, amount, and the due dates or period of payments under the lease contract, and the total amount of such periodic payments.

(e) Preempted: § 112(4)

(f) If the lessee is to bear the risk of the motor vehicle's depreciation, the estimated residual value of the motor vehicle at the end of the lease term.

(f) Preempted: § 112(10)(A)

(g) The amount or the method of determining the amount of any liability to be imposed on the lessee at the expiration of the lease term.

(g) Preempted: § 112(9)

(h) The amount of any security deposit received by the lessor as security for the performance of the lessee's obligations under the lease contract.

(h) Preempted: § 112(3)

(i) The amount paid or to be paid for current year vehicle tax or license fees.

(i) *Not* preempted

(j) A brief description of insurance provided or paid for by the lessor, including the type and amount of coverage and costs, or, if not provided or paid for by the lessor, the type and amount of coverage required of the lessee.

(j) Preempted: § 112(6)

(k) The description of, amount of or method of determining other charges payable by the lessee not included in the periodic payments.

(k) *Not* preempted

(l) A statement identifying all express warranties and guarantees made by the manufacturer or lessor with respect to the leased property, and identifying the party responsible for maintaining or servicing the leased property together with a description of the responsibility.

(l) *Not* preempted

(m) Any mileage limitation which will be utilized in determining a charge for excessive use or the estimated residual value of the motor vehicle, or both.

(m) *Not* preempted

(n) A statement whether or not the lease contract contains an express option to purchase the vehicle at the end of or during the lease term and at what price.

(n) Preempted: § 112(7)

California Vehicle Leasing Act (cont.)

(o) A statement of the conditions under which the lessee or lessor may terminate the lease prior to the end of the term and the amount or method of determining any penalty or other charge for delinquency, default or early termination.

(o) Preempted: § 112(5) and (8)

(p) A statement that the lessee shall be liable for the difference between the estimated residual value of the motor vehicle and its realized value at the end of the term.

(p) Preempted: § 112(1)(B)

(q) Notwithstanding any other provision of this chapter to the contrary, any information required to be disclosed in a lease contract under this chapter may be set forth in the manner required or permitted under federal law or regulation, as in effect at the time such disclosure is made. Nothing contained in this chapter shall be deemed to prohibit the disclosure in such contract of additional information required or permitted under federal law, as in effect at the time such disclosure is made.

(q) Not affected at all

(r) Any portion of the information required to be disclosed under this section may be given in the form of a reasonable estimate where the lessor is not in a position to know exact information.

(r) Not affected at all

§ 2986.2 Lease contract; contents; warnings; initials of lessee

Every lease contract shall contain, in at least eight-point bold type, above the space provided for the lessee's signature and circumscribed by a line, the following warnings which shall be isgned or initialed by the lessee:

(a) "Notice to the lessee: (1) Do not sign this agreement before you read it or if it contains any blank spaces to be filled in; (2) You are entitled to a completely filled in copy of this agreement; (3) If you default in the performance of your obligations under this agreement, the vehicle may be repossessed and you may be subject to suit and liability for the unpaid indebtedness evidenced by this agreement."

"s/s ________________"
lessee

(a) Not preempted

(b) "Warning—Unless a charge is included in this agreement for public liability or property damage insurance, payment for such coverage is not provided by this agreement."

"s/s ________________"
lessee

(b) Not preempted

(c) "Lessee has the right to return the vehicle, and receive a refund of any payments made if the credit application is not approved, unless nonapproval results from an incomplete application or from incorrect information provided by the lessee."

"s/s ________________"
lessee

(c) Not preempted

Washington Personal Property Leasing Act
[Ch. 158, S.B. No. 3299, 1983]

New Section. Sec. 4. (1) In any lease contract subject to this chapter, the following items, as applicable, shall be disclosed:

(a) A brief description of the leased property, sufficient to identify the property to the lessee and lessor.	(1) (a) Preempted: § 112(2)
(b) The total amount of any payment, such as a refundable security deposit paid by cash, check, or similar means, advance payment, capitalized cost reduction, or any trade-in allowance, appropriately identified, to be paid by the lessee at consummation of the lease.	(b) Preempted: § 112(3)
(c) The number, amount, and due dates or periods of payments scheduled under the lease and the total amount of the periodic payments.	(c) Preempted: § 112(4)
(d) The total amount paid or payable by the lessee during the lease term for official fees, registration, certificate of title, license fees, or taxes.	(d) *Not* preempted
(e) The total amount of all other charges, individually itemized, payable by the lessee to the lessor, which are not included in the periodic payments. This total includes the amount of any liabilities the lease imposes upon the lessee at the end of the term, but excludes the potential difference between the estimated and realized values required to be disclosed under (m) of this subsection.	(e) Preempted only as to end-of-term liabilities: § 112(9)
(f) A brief identification of insurance in connection with the lease including (i) if provided or paid for by the lessor, the types and amounts of coverages and cost to the lessee, or (ii) if not provided or paid for by the lessor, the types and amounts of coverages required of the lessee.	(f) Preempted: § 112(6)
(g) A statement identifying any express warranties or guarantees available to the lessee made by the lessor or manufacturer with respect to the leased property.	(g) *Not* preempted
(h) An identification of the party responsible for maintaining or servicing the leased property together with a brief description of the responsibility, and a statement of reasonable standards for wear and use, if the lessor sets such standards.	(h) *Not* preempted
(i) A description of any security interest, other than a security deposit disclosed under (b) of this subsection, held or to be retained by the lessor in connection with the lease and a clear identification of the property to which the security interest relates.	(i) *Not* preempted
(j) The amount or method of determining the amount of any penalty or other charge for delinquency, default, or late payments.	(j) Preempted: § 112(5)
(k) A statement of whether or not the lessee has the option to purchase the leased property and, if at the end of the lease term, at what price, and, if prior to the end of the lease term, at what time, and the price or method of determining the price.	(k) Preempted: § 112(7)
(l) A statement of the conditions under which the lessee or lessor may terminate the lease prior to the end of the lease term and the amount or method of determining the amount of any penalty or other charge for early termination.	(l) *Not* preempted as to "conditions," but preempted as to "amounts": § 112(8)
(m) A statement that the lessee shall be liable for the difference between the esitmated value of the property and its realized value at early termination or the end of the lease term, if such liability exists.	(m) Preempted: § 112(10)(B)
(n) Where the lessee's liability at early termination or at the end of the lease term is based on the estimated value of the leased property, a statement that the lessee may obtain at the end of the lease term or at early termination, at the lessee's expense, a professional appraisal of the value which could be realized at sale of the leased property by an independent third party agreed to by the lessee and the lessor, which appraisal shall be final and binding on the parties.	(n) Preempted: § 112(11)

Washington Personal Property Leasing Act (cont.)

(o) Where the lessee's liability at the end of the lease term is based upon the estimated value of the leased property:

(i) The value of the property at consummation of the lease, the itemized total lease obligation at the end of the lease term, and the difference between them.

(ii) That there is a rebuttable presumption that the estimated value of the leased property at the end of the lease term is unreasonable and not in good faith to the extent that it exceeds the realized value by more than three times the average payment allocable to a monthly period, and that the lessor cannot collect the amount of such excess liability unless the lessor brings a successful action in court in which the lessor pays the lessee's attorney's fees, and that this provision regarding the presumption and attorney's fees does not apply to the extent the excess of estimated value over realized value is due to unreasonable wear or use, or excessive use.

(iii) A statement that the requirements of (o)(ii) of this subsection do not preclude the right of a willing lessee to make any mutually agreeable final adjustment regarding such excess liability.

(o) Probably preempted in its entirety, under § 112(10)

(2) Any consumer lease which complies with the disclosure requirements of Title I of the federal consumer protection act (90 Stat. 257, 15 U.S.C. Sec. 1667 et seq.), which is also known as the federal consumer leasing act, as of the date upon which the consumer lease is executed, shall be deemed to comply with the disclosure requirements of this chapter.

(2) "Equivalency" provision. Effect would be to excuse lessor from making even non-preempted state disclosures.

For example, the Pennsylvania and North Carolina legislatures have recently amended their laws so that certain renewable leases have been recharacterized as retail instalment contracts or credit sales for disclosure and certain other state law requirements. If Title V is enacted, lessors in these two states will have to comply with both state laws that require disclosures relating to credit transactions, and federal law that requires different disclosures because the transactions would be covered by the definition of a lease under the proposed amendments to the Consumer Leasing Act.

Our proposal would prevent this anomaly and the resulting consumer confusion. We believe that leasing should be regulated, however, we submit that it differs from credit transactions and should be regulated differently. Congress recognized the difference, as evidenced by its treatment under the Consumer Leasing Act rather than the Truth in Lending Act; this amendment would ensure that Congress' determination be recognized by the states.

Under our proposal, a state could still decide that consumer leases should be subject to substantive limitations or regulations applicable specifically to them. Our proposal would only affect state laws to the extent that they recharacterize consumer leases, as defined by the Act, as some other type of transaction. It is in that sense similar to, but less invasive than, the provision of the Cash

Discount Act that prohibits states from characterizing cash discounts as a finance charge for purposes of the state's usury or other laws.

We believe that in those areas of law where the federal government has considered, analyzed, and made clear judgments and decisions, its determinations should be uniformly applied without regard to state law. This statement merely restates the Supremacy Clause found in the United States Constitution and reflects nothing more than the general rule that applies in all cases in which federal and state laws overlap.

This principle is as valid in the area of substantive rights and obligations as it is in the area of disclosure responsibilities. We therefore urge this Committee to consider adopting, at least on an experimental basis, a federal preemption standard that would override substantive state laws that differ from those provisions specifically considered and adopted by Congress in this legislation. In this as in all other areas where Congress has legislated, its decisions should be the final word on the issue being addressed.

National Bank Act Amendment

In a related issue, we would ask that the Committee consider an amendment to the National Bank Act that would add an additional paragraph to Section 5136 of the Revised Statutes, clarifying the authority of national banks to engage in leasing. Currently, the leasing authority of national banks is a matter of interpretation and court decisions defining national banks' lending powers. Because of this patchwork approach to leasing authority, national banks are subject to certain limitations in their leasing activities that are designed to make leases the functional equivalent of loans. These limitations are unnecessary and burdensome, and should be relieved by making explicit the authority of national banks to engage in leasing activities.

Comptroller of the Currency, T.C. Conover, in a letter to Senator Paula Hawkins dated November 1, 1983, endorsed the proposal contained in our testimony before the Subcommittee on Consumer Affairs on July 19, 1983. Mr. Conover wrote that "such additional authority is necessary at this point to bring about competitive parity between national banks and thrift institutions." Section 330 of the Garn-St Germain Depository Institutions Act of 1982 gave to the thrifts the power that we now request.

TITLE VI - FAIR DEPOSIT AVAILABILITY

Customers of depository institutions are entitled to have the use of deposited funds as rapidly as possible, consistent with principles of efficiency and with the safety and soundness of the payments system.(2) However, the

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2. For brevity, we shall often use the terms "bank" and "institution" in this testimony to mean a depository institution of any type. When we refer to banks strictly defined, we use the term "commercial bank".

imposition of delayed funds availability is the result of a fundamental flaw in the check collection system that adversely affects both banks and their customers. This flaw stems from the manual system of processing returned checks and is not easily remedied. Since delayed funds availability is an interstate problem, it calls for a federal solution. For that reason, CBA supports the concept of Title VI, which takes some important steps toward dealing with this problem.

In particular, CBA supports the provisions of Title VI that would require depository institutions to provide initial written disclosures to their customers of their general policy regarding funds availability. We also support the notion that funds deposited in interest-bearing accounts should begin to accrue interest as soon as the bank receives provisional credit. We are quite concerned, however, about the requirement in Title VI that telephone notice be given if a check over $250 is not paid. This requirement would be very costly to banks and, ultimately to their customers. We shall comment in detail on these matters later in our statement.

Before commenting on specific provisions of Title VI, we would like to provide some background on the present check collection system and its impact on the issue of delayed funds availability.

National Check Collection System

The problem of delayed funds availability must be considered in light of the provisions of the Uniform Commercial Code, adopted by all states, and of the national check clearing system. When one bank takes for deposit a check drawn on another, it must send the check through the national check collection system to obtain the funds the check represents. Checks are collected through a correspondent bank, the Federal Reserve System, a local check clearinghouse, or by sending the item directly to the payor bank on which it is drawn. In most cases, some combination of these methods is used.

The forward process of sending a check to the payor bank generally takes one or two business days from the date the check is first deposited. The actual time required will depend on a variety of circumstances, such as the number of intermediary institutions involved, holidays, weekends, weather, and mechanical breakdowns.

After receiving the check, the Uniform Commercial Code requires the payor bank to either pay it or return it unpaid by midnight of the day following the day it receives the check. The depository bank receives "provisional credit" for the check from the institution to which it delivers the check according to an availability schedule that reflects normal processing and transportation time for the forward process only, usually one or two business days. Since it is unknown whether the specific check will in fact be paid, any such grant of credit must be provisional and may be revoked if the item is returned unpaid.

Due to the uncertainty of whether it will receive final credit, the depository bank will be making a loan to its customer if it allows the depositor to withdraw funds at the same time that the bank receives provisional credit. In this situation, the bank is at risk that the item will be returned unpaid and that the provisional credit will be revoked. If this occurs, the bank may be unable to recover from its customer the funds withdrawn.

The forward check collection process is relatively fast, particularly since Magnetic Ink Character Recognition (MICR) encoding allows it to be accomplished through the use of high speed processing equipment. However, the return process is manual and therefore considerably slower.

A returned check must be processed manually because each endorsement stamp on the back of the check must be read to determine to which bank or institution the check must next be returned. Returning institutions frequently must decipher as many as five or six endorsements, often stamped on top of one another, to determine to which institution the check must next be returned. Each bank in the return process is required to dispatch a returned check to the next succeeding bank by midnight of the next business day following the day of receipt or else they may be held accountable for the check. Usually the institution merely places the check in the mail by the midnight deadline. Accordingly, the return process normally takes at least twice as long as the forward process. There is no incentive for the payor bank to more promptly inform the bank of first deposit that a check has been dishonored.

The Federal Reserve System suggests that a paying institution should wire notice to the bank of first deposit when a check of $2,500 or more is being returned unpaid. However, the Federal Reserve's wire advice provisions contain many ambiguities, such as the lack of any instructions as to whom wire notice is to be given or within what time frame. These provisions also fail to provide any indication of the consequences for a bank that provides an incomplete or erroneous notice or fails to provide one at all. Moreover, the wire advice will not always provide enough information to permit the depository bank to readily identify the particular customer who deposited the check or the branch of the depository bank that first received it.

As a way of eliminating the uncertainty inherent in the return process, some have suggested that the depository bank telephone the payor bank directly to determine whether any item has been paid. In light of the approximately 125 million checks that flow back and forth across the country every day, this procedure would simply be unfeasible.

Rational For Delayed Funds Availability

Ninety-nine percent or more of all checks are paid upon presentment. It is the less than one percent that are not paid that require banks to place holds on the proceeds of some items in order to protect the safety and soundness of the banking system. If banks were not permitted to place holds, they would be open to substantial losses from fraud and ordinary credit risk from funds advanced on items subsequently returned. Millions of dollars are lost in "check kiting schemes" each year. The only way a depository institution can protect itself fully against fraud and credit losses is to allow depositors to withdraw only against collected funds. Due to the delay involved in notification of return, hold times to protect the bank must be quite long, in some cases over twenty business days.

Another important factor causing banks to place holds is that state and federal regulatory agencies supervising depository institutions have taken the position that allowing depositors to withdraw against uncollected funds is tantamount to extending credit to the depositor. Such credit extensions must be included in determining whether a financial institution is adhering to applicable legal lending limits and in analyzing whether the institution is acting safely and soundly as required by banking laws.

Need For Legislation

Customer dissatisfaction with the delayed availability policies of depository institutions is beginning to express itself in state legislation. Both New York and California have recently enacted legislation to address the problem, and bills are pending in the states of Massachusetts, Florida, Maryland, and Hawaii. Your Committee is now considering the advisability of enacting federal legislation to deal with the same problem. The check collection system is a national system that should be governed by national standards. Therefore, we encourage enlightened federal legislation to set national standards regarding delayed funds availability.

More fundamentally, state legislation could have an adverse effect on the payments mechanism or on the safety and soundness of the banking system. For example, the bill that became the California Funds Availability Law initially proposed that a customer be presumed to be entitled to withdraw funds when the bank received provisional credit. If this presumption had been enacted, banks would have been compelled to take steps to protect themselves, such as the imposition of stricter standards in opening new accounts. Moreover, some of the necessary measures would have degraded the payments mechanism.

CBA recognizes the need to deal with the problem caused by the structural flaw in the manual handling of return items. However, no cost-effective solution has yet been found, despite considerable study by the industry and the Federal Reserve. Therefore, we encourage your Committee's efforts to find an equitable approach and encourage you to apply that approach uniformly nationwide, pre-empting the conflicting laws of any state.

Title VI

Title VI has a number of positive features that address the consequences of the structural flaw in the check collection system. First, we endorse the concept that financial institutions should provide initial disclosures to their customers of their policies regarding funds availability. In that regard, we support the provisions of Title VI that would require depository institutions to provide written disclosure of their general policy regarding availability of funds at the time an account is contracted for by the customer. We have already urged our members on several occasions to make this type of information available to customers. In order to avoid many of the problems depository institutions experienced with the design of the Truth-in-Lending disclosures, we would be happy to provide suggestions to the Committee on this particular section of the legislation.

If a depository institution has adopted a general funds availability policy for all or most items, the customer will already be aware of the hold that will be placed from the written disclosure received at the time of opening an account. Therefore, we respectfully submit that mandating additional disclosures, such as on preprinted deposit slips or envelopes for automatic teller deposits, would be duplicative and unnecessary. Deposit slips currently do not contain enough room to set forth this type of information. Instead, we suggest that an institution generally applying holds should make readily available at all locations the same disclosure of the general hold policy that it provides when an account is opened. For example, posters and brochures restating the institution's general hold policies might be placed in branches for customer information purposes.

We support the concept of crediting interest to an interest-bearing deposit account no later than the date on which the depository institution receives provisional credit for the deposit. Most CBA member institutions have already begun computing interest either on the date of deposit or when provisional credit has been received.

Recommendations

In order to improve Title VI, CBA makes three suggestions. As described above, we recognize that the manual processing of returned checks is the basic flaw in the check collection system. However, the provision in Section 606 of Title VI that would require the payor bank to notify the bank of first deposit within 24 hours if a check of $250 or more is not payable does not remedy the flaw.

This provision would impose great costs on banks and their customers, because the number of returned items of $250 or more is very large (though they represent a tiny fraction of all checks handled in the forward collection process). It would result in high service charges or lower interest payments to depositors (or both) in order to cover the increased costs. Most importantly, because this type of notification would require an even more labor-intensive effort than the present system, it conflicts with the concept of devising a more efficient system based on present and future electronic technology.

As an alternative approach to this problem, Title VI might require the Federal Reserve Board to develop regulations governing wire notice of non-payment of checks, based on its current instructions that banks should use wire notice for items in excess of $2,500. The Federal Reserve Board might be authorized to make reasonable adjustments to the $2,500 threshold amount, in the interest of safety and soundness, efficiency, and protection of depositors. In promulgating the regulations, the Federal Reserve Board must clarify to whom the notice is to be given and provide a specific time frame for notification. It must also specify the consequences of non-compliance with the regulations.

Our second area of concern is the civil liability section of Title VI, which essentially follows the Truth in Lending Simplification Act (TILA). The philosophy underlying the civil liability provisions of TILA was that the Act would be difficult to enforce because many creditors are not directly regulated by the federal financial regulators. As a result, a private right of action, with statutory damages and provisions for damages in class actions, was included in the TILA in order to promote compliance by all creditors. However, a federal statute regulating funds availability practices of depository institutions can be enforced adequately through the regular compliance examinations conducted by various federal depository institution regulators. As noted in the legislation itself, the federal regulators have a panoply of devices by which compliance can be readily ascertained by their examiners.

Furthermore, the damages provisions in Section 609 of Title VI establish liability far in excess of the potential harm to a customer. At most, it might be reasonable to impose liability for actual damages stemming from a depository institution's failure to comply with this legislation. However, the statutory and class damage provisions of Title VI far exceed any equitable consumer protection and would merely provide an incentive for unnecessary lawsuits. Defending those lawsuits would raise the costs of the banking industry and necessitate higher charges or lower interest payments for customers.

Third, we agree that the creation of a speedy return system for dishonored checks is needed. However, we question whether statutory imposition of an endorsement standard, as Section 605 provides, is the best way to meet this need. Solutions to the manual return system have been under study and discussion for many years by the Federal Reserve Board and various banking groups, but no cost-effective solution has yet been devised.

We applaud the efforts of the American National Standards Institute (ANSI) to develop national standards for check endorsements. However, implementing that particular standard would be costly and could take several years. Since the general goal is to reduce the time required to notify depository banks of returned checks, CBA strongly believes that the banking industry should work collectively with the Federal Reserve System to develop ways to meet the goal rather than being confined to the one approach embodied in the ANSI standard. Therefore, we believe Title VI should not require the Federal Reserve Board to issue regulations imposing an endorsement standard. Instead, the Federal Reserve might be instructed to determine, in cooperation with the industry, the advisability of a standard for check endorsements. The ANSI standard would be among those to be evaluated.

Solving The Flaw In The Check Collection System

Title VI goes a long way toward fulfilling the reasonable expectations of customers concerning access to their funds. However, the legislation does not solve the basic flaw in the check collection system that we described earlier in this testimony. We believe that there are several avenues that the Committee could explore in order to develop a solution to this problem.

First, the Committee might encourage the Federal Reserve System to continue to cooperate with the industry to minimize the effect of the inherent flaw in the check collection system. For example, the banking industry should make a serious effort to acquaint customers with the other services it offers that can provide collected funds far more rapidly. If customers knew that inexpensive, rapid, and final funds availability could be obtained by using fund transfer mechanisms other than checks, they would specify them when engaging in transactions for which finality is important.

Second, the industry and the Federal Reserve should explore further the possibility of automating the flow of return items, just as the forward check collection process is now automated, so that the depositor and the depository bank will know as quickly as possible if a check is not paid. Automated return item processing would remove much of the uncertainty from the system and reduce the need to delay availability on deposits.

Third, depository institutions should explore revisions to the Uniform Commerical Code in order to establish an incentive for the payor institution to provide rapid notice of dishonor.

CBA would be glad to work with your Committee to develop ways to deal cost-effectively with return item handling in the present check collection system. We all agree that the system requires creative innovations to continue to serve depository institutions and their customers well in the future.

TITLE VII - CREDIT DEREGULATION AND AVAILABILITY ACT OF 1983

Title VII of S.2181 would deregulate state price controls that govern financial institutions and other creditors on business, agricultural, and consumer loans. It also includes provisions that would retain state consumer protection laws and lender licensing requirements.

CBA strongly supports this legislation, which would further the deregulation of the cost of credit begun by the Depository Institution Deregulation and Monetory Control Act of 1980 (DIDMA). That Act permanently eliminated all interest rate ceilings applicable to first mortgage credit transactions and established a now-expired limited federal alternative to state interest rate ceilings for business and agricultural loans.

On the liability side, the Act provided for a six-year phase out of federal restrictions on the amount of interest depository institutions could pay on their deposits. The Depository Institutions Deregulation Committee (DIDC) was established to accomplish this mandate.

Since 1980, the DIDC has acted to achieve the goal of total deregulation of interest on deposits. It deregulated all time deposits of over thirty-one days in maturity. It eliminated minimum denomination requirements on Money Market Deposit Accounts (MMDA's), Super NOW Accounts, and ceiling-free, seven to thirty-one day accounts for IRA and Keogh investors. Further, it adopted a schedule that will eliminate the minimum balance requirement on the above accounts by January 1, 1986.

S.2181 also contains Title VIII - Interest on Demand Deposits, a provision that repeals the prohibition against the payment of interest on demand deposits. CBA supports the concept of this provision because we believe that it is a logical extension of the deregulation process. However, we ask that you view the deregulation process in its entirety. If financial institutions are to maintain their long-term viability, they must be able to adjust their revenues in response to their cost of funds and operating expenses.

The ability of financial institutions to pay market rates to depositors is dependent on similar flexibility in pricing mechanisms for credit products. Price controls prevent this essential flexibility and hamper the deregulation process. Further, price controls that were enacted to protect small and low-income borrowers from unscrupulous lenders have had unintended and adverse effects on borrowers, financial institutions, and the public, particularly during periods of inflation and contracted credit availability.

The volatile economic events of the past four years have clearly demonstrated that credit price controls only distort markets by having credit flow to deregulated states, and thus do not serve the interests of consumers or borrowers.

Institutions with sufficient resources will continue to relocate certain credit operations to states such as Delaware and South Dakota that have enacted laws reflecting the demands of the marketplace. Financial institutions with more limited resources cannot afford to relocate. Those entities that operate in states with restrictive ceilings cannot price their loans to accurately reflect their costs of doing business, and are therefore forced to offer fewer products and services and less credit. Consumers are then hurt by price controls since they are unable to obtain credit.

Relocation by financial institutions affects the economies of the states with restrictive rate ceilings. Jobs and income are lost as institutions move to states that provide a more realistic financial environment. The interests of the public, the attraction of additional capital and new business, the availability of credit for consumers and businesses, and the general employment situation are adversely affected by rate ceilings. The free flow of money between the states is biased toward states without rate restrictions since they provide an economic climate that encourages production.

States' price controls often differ depending on the type of loan and the type of institution that provides credit. This disparate treatment results in further inequality in the financial marketplace.

We believe that the increasing number of credit-granting institutions, coupled with the demands of the marketplace and increased consumer sophistication, will provide the controls necessary in the pricing of credit. Further, the recent substantial deregulation of liabilities makes the need to remove arbitrarily imposed asset limitations even more compelling.

We urge Congress to enact Title VII, the proposed credit deregulation and availability provision of S.2181, legislation that provides a realistic response to the national problems caused by state-imposed price controls.

CBA testified before this Committee on S.730 on April 12, 1983. As Title VII incorporates S.730, we would refer you to this testimony to further explain our position.

TITLE VIII - DEMAND DEPOSIT DEREGULATION ACT

You have invited comments on Title VIII - the Demand Deposit Deregulation Act, a provision that will allow all depository institutions to pay interest on both consumer and business demand deposit accounts. After analyzing Title VIII and the issues it raises, we believe that though legislation addressing these issues may cause some initial problems, ultimately it will be beneficial for both the banking industry and the public, particularly in the context of a deregulated market.

Title VIII is important because it permits customers and financial institutions the flexibility to establish financial arrangements that more accurately reflect todays financial services environment. Certain institutions and customers may continue to maintain their present arrangements due to their internal policies and local market conditions. However, others would have the option to take advantage of the benefits provided by this legislation.

Legislation similar to Title VIII represents an important step in the evolution of parity in the marketplace among various providers of financial services. Because such legislation will move us closer to parity, and because this parity will bring substantial competitive benefits to the marketplace, we support your efforts to further deregulate existing deposit account rate ceilings.

However, in view of the potential impact that this type of legislation will have on the earnings of financial institutions, we ask that you consider this provision in the context of the cost implications of S.2181 in its entirety. It is essential that Title IV, which provides for the payment of interest on reserves, apply to accounts authorized under Title VII and that it be enacted in conjunction with this provision as it is a potential offset to the increased expense that will result from the payment of interest on demand deposits. In fact, we could not support passage of Title VIII without the concurrent enactment of Title IV. In addition, some form of relief in the areas of product, geographic, and price control deregulation would mitigate the impact of Title VIII and contribute to the continued safety and soundness of our financial industry. In our testimony today, we have proposed modifications to Title VIII that may mitigate some of the expected disruption to the industry.

The Existing Prohibition Can No Longer Be Justified

As you know, many of the present limitations on this nation's financial institutions arose nearly fifty years ago. Included among these depression-generated restrictions was the prohibition on the payment of interest on demand deposits. In 1933 it was believed that a substantial shift of funds from rural financial institutions to the urban credit markets was occurring as a result of the ability of large money center banks to pay interest rates higher than those offered by smaller banks, thus diverting funds away from productive local uses and into speculative markets and activities. In addition, it was thought that a prohibition on such interest payments would improve the balance sheets of banks, making it easier for them to meet the newly-enacted FDIC deposit insurance assessments. Prohibiting interest on demand deposits was seen, therefore, as a way of protecting smaller local banks in particular and of helping all banks in general.

However, this prohibition on the payment of interest on demand deposits has long since ceased to serve its original goals. Furthermore, the prohibition is being circumvented and its effectiveness undermined by developments in the marketplace. First, the implicit payment of interest by financial institutions, in the form of services and interest rate adjustments on related loans, has become commonplace. Second, the money market mutual funds currently offer close substitutes for interest bearing demand deposits. In addition, deregulation of the legal environment has allowed the creation of new Super NOW accounts and Money Market Deposit Accounts (MMDAs), offering explicit interest on accounts that under many circumstances are the functional equivalent of demand deposits.

These developments call into question both the necessity for and the effectiveness of the existing prohibition. Indeed, the present prohibition leads to market distortions and anti-competitive tendencies that inhibit economic growth, adversely effect consumers and small businesses, and harm the competitive position of the very financial institutions it was intended to protect.

I would like to amplify further on two of these marketplace developments. First, it is well known that many commercial banks pay implicit interest to demand deposit customers in the form of free or below-cost services, including data processing, financial accounting and payroll activities, check collection and cash management services, and statement preparation and other deposit-related accommodations. For many users, the value of these services approximates what would be paid if explicit interest were allowed. However, many customers paid in the form of free services tend to overuse these services, beyond the point where the marginal value of the service to the particular customer is equal to its marginal cost. The result in these cases is a market in disequilibrium. This is especially true with respect to small businesses, which often cannot determine accurately the true costs they are paying for these "free" services. It has also become increasingly clear that many large and small banks have only a general understanding of what they are actually paying for demand deposits. Thus, the implicit payment of interest through services results in substantial "inefficiencies" in selling and purchasing demand deposits and substantial difficulties in identifying the actual costs of these deposit funds. These inefficiencies and pricing difficulties are a cost that will be eliminated if explicit interest is allowed on both individual and business transaction accounts.

Furthermore, forcing financial institutions to pay implicit interest for demand deposits can lead to a concentration of commercial demand deposits in those financial institutions better able to provide the services that attract these deposits. Institutions that can take advantage of economies of scale and cheaper internal sources of information and technology are able to offer "service packages" that other institutions, particularly smaller institutions, find hard to match. Thus, one of the odd results of the prohibition on the payment of interest has been to cause many commercial depositors to favor the money center banks or regional banks over the smaller rural financial institutions, a result just the opposite of that sought by the 1933 banking legislation.

In our opinion, these costs and inefficiencies will be alleviated if payment for the time value of money can be made in cash rather than in services. In essence, legislation similar to Title VIII would allow financial institutions to move out of barter and into a currency-based marketplace. As a result, depositors would be able to judge more accurately the particular benefits offered to them. In a market rate environment, as the MMDA experience has demonstrated, all financial institutions can effectively compete for funds, and small institutions can retain and attract funds in local communities for neighborhood uses.

When considering this provision, it is also important to focus on a second marketplace fact. In essence, the prohibition on the payment of interest on demand deposits represents a form of government imposed price fixing. Since 1933, the federal government has declared a universal price on demand deposits. Nevertheless, like all price fixing efforts, this action can be successful only if the entity fixing the price has control over the entire marketplace, or if all of the providers of the product agree to cooperate in honoring the established price. In the case of demand deposits, however, the federal government does not have control of the marketplace. The existing prohibition applies only to traditional financial institutions and not to the new quasi-financial institutions, such as money market mutual funds, providing similar services. While these quasi-financial institutions are aggressively competing for business demand deposits by paying market rates for such funds, banks and other financial institutions have been able to respond only by paying market rates for limited transaction MMDAs and limited customer Super NOW accounts. As a result, the current prohibition has not stabilized the price of demand deposits, but only distorted the competitive balance in pursuing such deposits.

At the present time it is, for the most part, only the large corporations that have direct access to the money markets to minimize the amount of noninvested funds in their demand deposit accounts. Similarly, the use of cash management accounts to maximize the return on available funds has not been readily available to most small businesses. As a result, small businesses are generally forced to choose between depositing these demand deposit funds in a regulated financial institution, which pays for them with services they do not value or that do not fully compensate them, or investing these deposits in uninsured accounts at quasi-financial institutions. Title VIII would allow our members to offer payment to consumers and small businesses that more accurately responds to their needs and desires.

Competitive Equality Requires the Enactment of Title VIII

In 1980, Congress mandated the gradual removal ot deposit interest rates in the Depository Institutions Deregulation and Monetary Control Act. This Act authorized nationwide NOW accounts and established the Depository Institutions Deregulation Committee (DIDC) to implement the phase out of deposit rate ceilings. The express purpose of this congressional action was to permit the nation's financial institutions to compete equally with each other and with quasi-financial institutions, such as money market mutual funds. Although the DIDC made some progress toward deregulation of interest rate ceilings during the first two years of its existence, it was unsuccessful in its efforts to provide financial institutions with a transaction account that was truly competitive with the money market funds. In 1982, the DIDC asked Congress to provide further guidance on the characteristics of a competitive market-rate transaction account. Congress responded to this request by enacting Section 327 of the Garn-St Germain Act of 1982, legislation directing the DIDC to establish an account that is "directly equivalent to and competitive with money market mutual funds."

While financial institutions have been able to compete effectively with money market mutual funds for certain consumer deposits by offering MMDAs and Super NOW accounts, they are not able to compete effectively for business deposits. Significantly, two thirds of the funds invested in money market funds come from rate sensitive institutional investors that require unlimited transactions. Yet at present, only the money market funds enjoy the ability to pay interest to their commercial or institutional customers on the functional equivalent of demand deposit accounts. This market advantage is contrary to the purpose and intent of the Garn-St Germain Act.

DIDC Minimum Balance Proposal

Mr. Chairman, at the request of the DIDC, you introduced this legislation to permit the payment of interest on all transaction accounts. Title VIII imposes an interest rate ceiling on accounts of less than $2,500 because the DIDC believes that such a minimum balance requirement is necessary to prevent circumvention of the present minimum balance requirement on the MMDA and the Super NOW account. CBA agrees with the imposition of a minimum balance requirement, but only on an interim basis. There is a precedent for this minimum balance requirement in the MMDA and the Super NOW account, which have attracted over $400 billion since their introduction. More importantly, the imposition of a minimum balance requirement on an interim basis could significantly lessen the financial impact of legislation, particularly as it affects smaller financial institutions.

CBA strongly urges that the legislation be enacted in such a way as to ensure that interim political measures do not become permanent competitive obstacles, and that your fundamental goal in pursuing Title VIII, the ability to pay interest on all demand deposits, is achieved. In order to ensure this result, you might consider statutorially phasing-in the authority to pay interest on demand deposits in three stages.

First, the legislation could eliminate the current eligibility requirements on NOW accounts and require that the DIDC eliminate them on Super NOW accounts. This would permit financial institutions to pay up to 5 1/4 percent interest on both business and consumer transaction accounts with balances below $2,500 and market rates on higher balance accounts. Under this proposal, institutions would be permitted to impose higher balances if internal and market conditions warranted them. We ask that a substantial lead time be provided so that institutions can analyze the cost effects.

Second, Congress could mandate that the minimum balance requirement on the new business Super NOW account be reduced to $1,000 on January 1, 1985 and eliminated by January 1, 1986. We believe it to be essential that any reductions in the minimum balance requirements for the MMDA and the existing Super NOW account also apply to the new business account.

Third, the legislation should make it clear that both the minimum balance requirement and the general prohibition on the payment of interest on demand deposits will terminate entirely in 1986, together with all other ceilings and restrictions on deposit account interest rates.

Finally, the account should be classified as a new account so that it would qualify for the payment of interest on reserves under Title IV. This statutory schedule will accomplish the fundamental goal of Title VIII, and it will also lessen the transitional impact of the legislation on smaller financial institutions.

Title VIII Does Not Threaten the Safety or Stability of Banks and Thrifts

It is safe to assume that a large number of business depositors will use the resulting market rate transaction accounts and that in the aggregate a substantial number of dollars will be deposited in such accounts. This assumption is based on our experience with the MMDA and the Super NOW account. In many instances this will temporarily increase the interest segment of our operating costs. However, it does not follow that overall operating costs will rise or that the new business transaction account will pose a significant threat to the balance sheets of our financial institutions.

Various estimates have been made of the first-year costs to financial institutions of unlimited interest bearing transaction accounts. In particular, the DIDC staff has projected the possibility of a $1 to $2 billion decrease in first-year profits as a result of the payment of interest on demand deposits. This is a decrease in _profits_; it is not a projection of net loss to the industry.

According to DIDC figures, legislation such as H.R. 3575, introduced in the House by Congressman St Germain, will cause industry profits to fall by 5 to 10 percent, translating into a $1 to $2 billion decrease. However, this estimated 5 to 10 percentage points includes between 1 and 2 - 1/2 percentage points directly attributable to household deposits. As stated earlier, maintaining a $2,500 minimum balance requirement alone, as provided in Title VIII, should eliminate this portion of any projected decrease in profits, since individuals with deposits of greater than $2,500 have already shifted, or can presently shift, to interest bearing MMDAs and Super Now accounts. As a result we believe that this projection is higher than what would actually occur under your proposal.

We have discussed the impact on pre-tax profits with a number of our members, and unfortunately find it difficult to provide you with projections because too many assumptions and variables affect any analysis. For example, it is difficult to estimate how many customers will convert this new account. Some may prefer to continue to receive implicit interest in the form of services now offered, especially in view of the fact that they would have to pay income tax on the interest they would receive. In addition, some banks cannot realistically assess the funds at risk that would be affected because of the varying contractual arrangements with their customers. Further, our experience with NOW accounts, MMDAs, and Super NOW accounts has demonstrated that a considerable number of customers simply do not convert their funds when given the option of a market rate.

Other factors could also mitigate the potential revenue loss. As we discuss in this testimony, Title IV, if enacted, would permit the payment of interest on reserves held by the Federal Reserve System. This factor could, to some degree, offset the costs.

Service fee income would provide some relief. As we have stated, many banks do not presently charge for their services and could recoup some of the losses by imposing explicit fees for these services. It is also possible that a financial institution's expenses may be reduced because some depositors may shift their accounts from higher yield accounts in order to take advantage of the liquidity of a demand deposit.

Just as the MMDA attracted new money into financial institutions, the payment of interest on demand deposits may provide new funds, and the interest spread could mitigate the impact on earnings.

It does not necessarily follow that the cost of credit will rise as a result of the legislation. Rather, the factors we have just outlined will mitigate the impact of the Title VIII. However, all of these decisions will depend on the deposit base, the market, and internal bank policies.

A transitional period may follow the enactment of legislation similar to Title VIII, and this period may be difficult for some institutions. The DIDC itself has indicated, however, that financial institutions will soon experience these difficulties, in any event, when all existing ceilings on transaction accounts are removed as required by the 1980 Deregulation Act.

Congress could further lessen or substantially eliminate the transitional costs of this legislation by concurrently proceeding with deregulation of product and geographic restrictions to permit financial institutions to more fully utilize their existing delivery systems and to enjoy greater economies of scale in their retail and wholesale banking activities. Similarly, the removal of existing state price control restrictions would permit financial institutions to price their loans on a market basis, just as the price of their deposits is shaped by market forces.

CBA strongly urges Congress to proceed promptly with these deregulatory efforts, for they are equally significant for the overall competitive viability of this nation's financial institutions.

Conclusion

Allowing financial institutions to pay interest in cash rather than in kind will allow the market to work, and with no expected risk to the financial community other than the transitional risks one associates with any market change. Small businesses and small depositors, as well as the financial institutions themselves, will benefit from the removal of this artificial constraint on our industry. CBA does not seek the imposition of artificial constraints on other institutions, whether in the form of moratoria or new reserve requirements on money market funds. We only request the parity necessary to enable our members to compete evenly with other providers of financial services in a fully deregulated marketplace.

TITLE IX - FRAUDULENT USE OF CREDIT CARDS AND DEBIT CARDS

In recent years there has been a dramatic increase in the types of crimes associated with credit and debit cards. CBA believes that the growing incidence and scope of criminal activity require an equally comprehensive response. We strongly support the provisions of Title IX of S. 2181 that would amend the fraud provisions of the Truth in Lending Act and Electronic Fund Transfer Act to cover the fraudulent use of account numbers and the possession of counterfeit cards.

We believe that this major problem also requires the creation of a new chapter of Title 18, the U.S. Criminal Code, that would provide a complete statutory treatment of this expanding problem. Recently, Senator Thurmond introduced S. 1870, which contains the needed amendments to Title 18. We urge the Committee to support S.1870, which will be considered on the Senate floor shortly.

The first provision of Title IX is mandated both by changes in technology and a new area of fraud that recently has given rise to substantial losses. This involves the fraudulent use of account numbers that often can be used without any card or device issued with respect to the account. For instance, a perpetrator might call an unsuspecting consumer and, through a variety of ploys, obtain the consumer's account number. Account numbers can also be obtained from discarded carbon paper that will reveal the number upon close examination. These account numbers may then be used in a number of ways, including the purchase by telephone of goods or services. The earliest point at which the fraud can be discovered is when the consumer receives a periodic statement reflecting the fraudulent activity. In most cases, by that time the perpetrator has obtained the goods or services and is long gone.

This provision would simply recognize that account numbers are another way of gaining access to the account. It would then cover their improper use in the criminal provision. Though a reasonable reading of the existing statute might suggest that the current provision should already be read in this manner, at least one court has ruled that this is not the case. We believe that this potential loophole will be corrected through the limited amendments to Section 134 of the Truth in Lending Act and to Section 916 of the Electronic Fund Transfer Act.

The second and far more technical amendment in Title IX relates to the calculation of certain dollar amounts relating to fraudulent use. In establishing a threshold amount to trigger liability, the existing statutes provide that transactions must involve at least $1,000 and the use of a credit or access device. The technical question that has arisen is whether the $1,000 amount must be met with respect to a single transaction, or whether it relates to one or a series of transactions. Similarly, there has been some confusion as to whether the test can be met with more than one card or device, or whether it is limited to a single card or device. In this area, the limited judicial attention that has been paid has produced the clearly appropriate conclusion that the current language should be read as including "one or more," both with respect to transactions and to cards or devices. Despite that judicial recognition, CBA believes that the criminal provisions of these two statutes should be amended to make absolutely certain that fraudulent activities will not escape prosecution on the basis of this possible loophole.

In addition to these two amendments, we urge the members of this Committee to support S. 1870, which deals in a more comprehensive way with the increasingly pervasive problem of credit and debit card fraud.

TRUTH IN LENDING

RESCISSION

Although the Truth in Lending Act (TILA) has traditionally been viewed as a credit cost disclosure statute, it also contains sections that provide substantial consumer rights and protections. Though a review of all such provisions is warranted, the rescission provision is in particular need of revision.

Over the past 15 years this provision has been the source of significant customer confusion and irritation, and the source of significant compliance problems for all financial institutions due to its complex requirements. It is the most infrequently used consumer protection provided under the TILA and is considered one of the most burdensome.

The rescission provision, Section 125 of the TILA, provides that any consumer whose dwelling secures an extension of credit that is not for acquisition or construction can rescind that transaction up to three days after certain events occur. Those events include the creditor's delivery of all "material" Truth in Lending disclosures to the consumer; delivery of two copies of the forms and notices for rescinding the transaction to all consumers holding an interest in the dwelling securing the loan; and the consummation of the transaction. Once all three events have occurred, the three-day rescission period begins. The provision also requires that copies of the rescission forms and notice be provided to anyone with any legally recognizable interest in the dwelling. Obviously, this imposes additional business operating costs that are ultimately passed on to all consumers.

During the three-business-day waiting period no funds can be disbursed to the consumer. Since rescission can be exercised by mail, the Federal Reserve Board Staff Commentary indicates that creditors should either wait longer than three business days (usually five) or require all consumers who received the rescission notice to sign a statement indicating that they do not intend to and have not rescinded the transaction.

Since consumers must go through an extensive application process in connection with this type of credit review (possible property appraisal, title search, and the necessary steps to create a mortgage), they naturally find this three-day delay to be unreasonable. This is especially true since the usual time to receive approval is three weeks.

Many of these loans are for considerable amounts ($20,000 plus). Therefore, substantial thought has usually been devoted by the borrower prior to even making an application for credit. It is unlikely that potential borrowers wake up one morning and run down to the bank to quickly apply for a loan. For example, a medium sized West Coast bank that generates over 1,200 rescindable loans a year averaged .60 rescissions/year in a five-year period.

In 1978, when this Committee was considering the Truth in Lending Simplification and Reform Act, CBA conducted a survey of its members regarding exercise of rescission rights by consumers. The results indicated that the rescission right was rarely, if ever, exercised. Some banks reported that it occurred maybe once or twice a year but for the overwhelming majority, it never occurred.

CBA has again surveyed its membership on this issue. This survey is far more extensive than the previous one. Initial results reconfirm that the rescission right is rarely exercised. The survey also shows that in connection with this type of credit, the delinquency, default, and foreclosure rate is very low. Within two weeks the results of the survey will be submitted to the Committee for the record.

In reviewing the underlying policy reasons for adding this provision to the proposed TILA in 1968, we find that it does not justify application of this requirement to direct bank loans. When TILA was under consideration on the House floor, Congressman William T. Cahill (R-NJ) offered an amendment giving the customer the right to cancel transactions involving second mortgages three days before final consummation (see Cong. Rec., January 31, 1968, H. 631). In explaining the need for the amendment, he noted that homeowners were being defrauded by home improvement salesmen and that the consumer never received a credit-cost disclosure to show that the interest rates on these transactions were running 30 to 40 percent, or that a lien was being taken on the consumer's home. Subsequently, the closed-end disclosure provisions under Regulation Z require that this information be provided to the consumer in separate segregated disclosures before the transaction is consummated.

Second, Congressman Cahill noted that since brokers were arranging these transactions, the consumer was unaware that the loan would be sold to a finance company.

Third, Congressmen Cahill explained that lending institutions that bought paper from contractors and other merchants who engaged in fraudulent tactics could be insulated from consumers' claims and defenses under the holder-in-due-course doctrine. However, in November 1975, the FTC promulgated a trade regulation rule on "Preservation of Consumer Claims and Defenses." This rule effectively wiped out any state laws allowing the application of the holder-in-due-course doctrine to credit sales involving consumers. Therefore, this concern is no longer valid.

Senator William Proxmire (D-WI) confirms our interpretation of the public policy intent behind the Cahill amendment. On February 2, 1968, Senator Proxmire indicated that the provision was aimed at fly-by-night contractors who provide shoddy home improvement work (Cong. Rec,. February 2, 1968, S. 821). Moreover, when the conference report came before the House, the author of the legislation, Congresswoman Lenore Sullivan (D-MO), indicated that the rescission provision was intended to stop "home improvement racketeers". (see Cong. Rec,. May 22, 1968, H. 4118).

The legislative history clearly shows that the rescission provision was aimed at credit sales by contractors, rather than at direct loans by banks. We would note that while the House-passed bill contained a three-day notice provision or cooling-off period before consummation, the conference committee converted this concept into a rescission provision. There is no explanation for the change.

Therefore, we urge this Committee to recognize that the three-day rescission requirement should not apply to direct loans.

When the rescission provision was added to the Act, the provision of open-end credit by financial institutions was in its infancy. During the 1970's the use of bank cards or checks that were attached to a line of credit grew substantially and became a major means of providing consumer credit in an efficient, low-cost manner. Many far-sighted lenders questioned the continued efficiency of requiring consumers to apply separately for and obtain separate loans for their various credit needs such as automobiles, home improvements, education, vacations, debt consolidation, short-term demand notes, and various other reasons.

Therefore, programs were developed in which a consumer would be granted a long line of credit (usually $20,000 plus) to be secured by his/her dwelling. Many consumers use their lines of credit as a hedge against inflation by taking advantage of seasonable and clearance sales. Thus, borrowers have access to credit when it is needed but do not pay interest until the credit is actually used. This line could be accessed by special checks usually with a minimum draw-down of $500 or act as an overdraft feature to an existing checking account.

As the industry has gained more experience with these programs, the minimum has been dropped or completely removed. Some institutions are now allowing access through regular credit cards. There was also recognition that the single most important asset for most consumers, their home equity, was not being employed to help meet their credit needs. Since the loan is secured by real estate, the credit is cheaper because the collateral reduces the risk to the lender. Repayment terms tend to be more favorable since 2 to 5 percent of the balance is due each month, and in contrast to other loans there is no early repayment penalty.

Since an integral part of these programs was the securing of the line of credit with a second mortgage on the consumer's dwelling, the rescission provision of TILA came into play. Obviously, the various requirements of Section 125 could not easily be met in any type of open-end credit plan where the consumer can purchase goods or obtain cash advances at will.

The Federal Reserve Board attempted to solve the problem through a regulatory change that accommodated the operational problems. However, Consumer's Union filed suit challenging the Fed's authority, and the Board decided to withdraw the regulation and ask Congress to resolve the problem.

The 1980 Truth in Lending Simplification and Reform Act addressed this issue. The Senate-passed bill handled the problem by providing an exception to the rescission requirement for every open-end extension of credit secured by a dwelling. However, the House argued that consumers would use these accounts to purchase "toothpaste" and thus secure such purchases with their dwellings. While the Senate conferees felt that this argument was disingenuous, the House held firm on its position. Therefore, a compromise was agreed upon in which the exception would be allowed to operate for three years from the Act's effective date, during which Congress and the Fed would monitor such progress to see if abuses occurred. If none occurred, it was expected that the exception would be extended or made final.

We would like to point out that the exception is not without consumer protection. First, the typical rescission rights are provided when the plan is opened or when the amount of the line of credit is extended. Therefore, the consumer is not denied the consumer protection envisioned by the Congress.

A limited survey of some of our West Coast members indicates that the average draw-downs are $4911, which refutes the idea that consumers are purchasing "toothpaste." The participants in this survey indicated that consumers are using such lines of credit for major purchases because of the convenience and lower interest rates associated with such

APPENDIX A

SURVEY OF CHECKS ON REAL ESTATE SECURED OPEN-END CREDIT LINES PAID DURING DECEMBER 1983

DOLLAR AMOUNT OF CHECKS	NUMBER OF CHECKS PAID	TOTAL DOLLAR AMT. OF CHECKS PAID	AVERAGE DRAW-DOWN
$ .01 - 300	1,632	$ 313,243	$ 192
$ 300.01 - 1,000	4,572	$ 3,023,474	$ 661
$ 1,000.01 - 5,000	5,292	$13,428,497	$ 2,538
$ 5,000.01 - 10,000	1,393	$10,256,581	$ 7,363
$10,000.01 & over	1,622	$44,238,320	$27,274
ALL CHECKS	14,511	$71,260,115	$ 4,911

plans. A copy of the limited survey results is attached as Appendix A of this section. Presently, we are surveying our entire membership on this issue and will provide the Committee with the results before the closing of the record on these proceedings.

In our view, the continued imposition of the Section 125 rescission provision on direct bank loans is unwarranted. However, if the Committee believes that the rescission right should be provided in some limited form, we believe the present exception for secured open-end plans should be made permanent. The present uncertainty discourages many institutions from offering this product or from making it more widely available. Congress' failure to resolve the problem will only serve to deny consumers cost efficient methods of obtaining credit.

RELATIONSHIP OF FEDERAL DISCLOSURE REQUIREMENTS TO STATE LAW

Though this Committee made great strides to simplify Truth in Lending in 1980, the provision governing the extent to which state law would be preempted was left essentially the same as under the original Act. The limited preemption rule in the present law leaves most state disclosure laws intact, so that creditors must comply with both state and federal disclosure requirements. This double responsiblity makes form design and execution problematical, and subjects creditors to possible double sanctions for violations. The overlay of state disclosure laws on top of the Truth in Lending rules produces disclosures that are lengthy, redundant, and confusing.

The TILA provides that state disclosure laws are preempted only to the extent they are "inconsistent" with federal law and then only to the extent of the inconsistency. Section 226.28(a)(1) of Regulation Z interpreting the Act preempts state law only "if it requires a creditor to make disclosures or take actions that contradict the requirements of the federal law." Thus the level of preemption is further narrowed. The Regulation and the Commentary provide some examples indicating that this is a very limited preemption rule, and disclosures of additional, different, or more detailed information under state law do not usually contradict the federal rules.

The net result is that the present TIL preemption standard is very narrow. Absent flatly contradictory terminology, the federal Act has no effect on state disclosures that are not "functional equivalents" of federal disclosures. The state disclosures that are functional equivalents are preempted only in those cases where actual conflict arises, i.e., where state law numbers or terminology are incompatible with the TIL disclosure. At the same time, when a state law item is preempted, it is totally barred; it may not appear anywhere in the transaction documents, not even separately from the TIL disclosures.

Another formula against which the various state laws could be evaluated was found in S. 1720 of the last Congress. This proposal seems designed to be more broadly preemptive than the present Regulation Z.

Under this proposal the threshhold question of which state laws are preempted must be answered in two steps:

1. Is the state law "similar in nature, purpose, scope, intent, or effect" to TIL?
2. If so, does the provision at issue require anything "different" than TIL requires?

The breadth of the language used in the Senate proposal presents interpretational problems. A host of state laws could be "similar" to TIL under one or more of the five terms that are set out in the alternative. For example, the entire Uniform Consumer Credit Code is similar to TIL in "scope," i.e., range of transactions covered. Further, does one look at an entire state statute to make the initial determination of similarity, or does one apply that test provision by provision? Two assumptions should be made with regard to the language: (1) state laws must be analyzed section by section; and (2) a state provision satisfies the "similar to" test if it requires creditors to give any specific information about the terms of closed-end credit transactions, or about the terms or activity of open-end credit plans.

Within the large class of state law provisions, there are candidates for preemption under the first-stage critera;

the Senate proposal zeroes in on those provisions that "differ" from TIL in the specified ways. On analysis it is not clear whether this language really narrows the preemptive effect. Apparently any state law disclosure would be preempted if it varies in any manner -- "scope, content, form, terminology, placement or timing" -- from the TIL rules.

This proposal could have an important effect on creditor liability. Consider a state that adopts the TIL rules as state law (explicitly, or by incorporation by reference, or by use of an "equivalency" provision) and provides a separate or larger penalty for violations. Under the Senate proposal, state law rules are preempted only if "different," and not if they are identical. State law rules that are the same as TIL remain in place. Though in this case the creditor's compliance burdens would be satisified by a single disclosure, the creditor could be exposed to separate or multiple sanctions for violations.

Additionally, some commentators have raised a "contract validity" issue that we view as something of a red herring. It is virtually impossible to readily tell whether a particular state disclosure has substantive contractual implications. Some obviously do not; many probably do, in some fashion. For example, in a typical loan contract, the parties will need to set out somewhere the basic terms (amount of loan, charges and fees, payment schedule) in order for a court to recognize the contract as an enforceable agreement. Sometimes the disclosure statute will say or intimate that all specified terms must be included or the contract is unenforceable. Moreover, our legal system generally gives the parties to a contract considerable freedom to amplify their agreement in as much detail as they wish. If, for example, the parties choose to itemize the finance charge, they have decided that their contract requires that detail. Through whose eyes is the contract validity question to be viewed: the parties', a court's, the state legislature's?

This suggests that there remains a fundamental conflict underlying the preemption issue that may be unresolvable without major restructuring of the nation's consumer credit laws. The conflict is between the limited goals of TIL (standardized disclosure) and state law that incorporates disclosure features into broad-based regulatory schemes. Unless Congress is willing to preempt those state regulatory systems in their entirety, the alignment of federal and state disclosures will remain elusive.

Perhaps the most disconcerting effect of the present formula is its "swiss cheese" effect on creditor forms. Some state disclosure items will remain, others will be preempted, and still others are preempted only if a specific transaction's details make them contradict federal disclosures. Already there are potential inconsistencies in the Fed formula. For example, "rate at which the finance charge is computed" is not preempted, even though a circuit court under the old TIL found it to contradict the APR disclosure, but "time price differential" _is_ preempted where it equals the TIL finance charge. What then of a state disclosure of the "rate of the time price differential to be charged?"

Nor does the present standard clearly resolve noninformational aspects of state law, such as disclosure format or timing. Although the present formula defers generously to state law, it may create nightmarish interpretational and compliance problems, to say nothing of lengthy, redundant disclosures.

Possible Alternatives

In general terms, the appropriate function of a preemption rule would seem to be to identify the core purposes of the federal law, and then to make sure that state requirements do not unduly disrupt or interfere with those federal goals. At some risk of over-simplification, the core purposes of the TIL disclosure rules might be stated as follows:

1. To assure that consumers in closed-end transactions receive certain credit information (but not all possible credit information) before consummation, in a distinctive format, with some distinctive terminology, and without excessive detail.
2. To assure that consumers in open-end plans receive certain credit information (but not all possible credit information) about the plan when it is

established, and at specified points thereafter, without excessive detail, without a rigid format, and with very little distinctive terminology.

3. To do the above in a manner likely to maximize consumer understanding and use of the information disclosed, while also minimizing creditor compliance burdens.

This suggests certain premises for further analysis. Swiss cheese forms seem inherently dysfunctional; so do disclosure statements and contracts that contain "inconsistent state disclosures" labeled as such (as the prior regulation permitted). So also do documents that simultaneously break out contract details in one fashion for federal purposes and in another form for state purposes. Conflicting terminology is another obstacle. Finally, state disclosures of additional, non-duplicative information may lengthen contract paperwork and create confusion if provided at different times and in different forms.

State disclosures that create these problems should therefore be barred, or at least discouraged. One possibility would be to borrow the idea of the "equivalency provisions" that have been enacted in several states. Essentially, an "equivalency provision" provides that federal TIL disclosures can be substituted for required state disclosures. Thus TIL would say, in effect, that any creditor who complies with TIL cannot be held liable for failing to comply with any state law requiring disclosures _comparable_ to TIL in content, terminology, and time of delivery. This would remove the threat of state liability for nondisclosure, and it would do so nationwide without depending on the state legislatures to enact and update specific provisions on their own.

What this approach does not do, however, is mandate the deletion of the state disclosures. The creditor is protected if the state disclosures are omitted, but is free to continue to make them if it chooses.

Recently, the Council of the Section on Corporation, Banking and Business Law of the American Bar Association adapted a report from its Committee on Consumer Financial Services regarding the preemption issue. The Committee had spent five years studying the relationship between federal and state disclosure law and found that the "comparable" provision is most acceptable. In arriving at this conclusion, the Committee felt the following public policy considerations should be paramount in devising a preemption position:

> 1. State disclosures that call for duplicative, parallel, or more detailed information ought to be displaced to the extent possible in order to reduce the length, complexity, and redundancy of disclosure statements and contract documents.
>
> 2. At the same time, creditors ought to be free to include information that they deem necessary or desirable for contract purposes.
>
> 3. Creditors ought not to be subject to double liability, i.e., under state and federal laws, for essentially the same disclosure.

This approach would accomplish these objectives in larger measure than either the present law or the other approaches considered. In substance it would excuse creditors from having to comply with any state disclosure law that is duplicative or the TIL rules (even though the state law may require more or less detail or different terminology), but would permit creditors to retain in their contract documents any state law information the creditor desires to use for contractual or other purposes. This formula would affect many more state laws than the present preemption rule: the latter affects only state laws that "contradict" the federal rule, while the Committee formula is related to any state disclosure rule that is "comparable in content."

The salient features of the comparable standards are:

1. It zeroes in on state laws that are "comparable in content and time of delivery," i.e., duplicative, of the disclosure rules in Chapter 2 of the TIL Act, and specifically provides that "it shall not constitute a violation of state law" if the creditor omits such disclosure.
2. At the same time, since the state law disclosure is not prohibited, creditors may continue to include the information in credit contract documents. This assures that creditors need not eliminate contract provisions necessary for the enforceability of specific terms.
3. "Comparable in content" is defined in a way that clearly identifies which state disclosure laws are affected.
4. Creditor liability may still exist under state laws that are carbon copies of TIL, but a creditor cannot be hit with a double sanction, either administratively or in civil actions.
5. The Federal Reserve Board, upon request, is directed to make determinations about which state laws are comparable in content and time of delivery, and therefore subject to this limited rule.

The phrase "comparable in content and time of delivery" is the key. The provision elaborates on what is comparable content, and is intended to pick up any state law disclosure relating to those components and terms of the credit transaction that are subject to disclosure under TIL Chapter 2. The comparability of "time of delivery" refers to stages of the transaction. Thus any state disclosure required at or prior to closing would be covered. For example, if TIL would require early estimated disclosures while state law would permit disclosures at settlement, compliance with the state law would be excused.

The effect of the draft language can best be understood through examples. It would preempt (i.e., excuse the creditor from complying with) the following state-law disclosure requirements:

- Any different or more-detailed itemization of the total sale price, amount financed, finance charge or total of payments, or any components of these sums. This would affect state retail instalment sales acts in particular, both for open-end and closed-end transactions.
- State terminology different from TIL, but referring to the same item.
- Disclosures based on old Regulation Z (often adopted explicitly or by reference in the states).
- State laws that require different or more detailed explanations of textual TIL terms, such as security interest coverage, late payment charges, prepayment rebates, or assumability.
- Itemizations of insurance charges or voluntary disclosures.
- Disclosures about variable or adjustable features of the transaction.

- State rescission notices (if the transaction would also be rescindable under Regulation Z).
- Transaction descriptions on open-end periodic statements.
- Descriptions of periodic or annual rates, balance assessment methods, or other charges on open-end initial or periodic statements.

By contrast, this formula would have no impact on the following types of state laws:

- Mandatory disclosures about aspects of the transaction that are untouched by TIL, such as "warning clauses," descriptions of insurance coverage and claims procedures, warranties, escrow notices, etc.
- Disclosures required at later stages of the transaction, such as annual statements of account, disclosures for deferrals, consolidations and extensions that are not TIL refinancings, rate-change notices in variable-rate plans, or repossession notices.
- Co-singer notices.
- Notice of assignment.
- Payment receipts.

It is recognized that the proposal would leave in place some significant (albeit incidental) state disclosure rules of the types just listed. At the same time, since creditors would be free to omit state disclosures that are functionally duplicative of TIL disclosures, there would be inducements to shorten and streamline the basic transaction documents -- a goal consistent with the TIL simplification effort.

The provision also deals expressly with the "contract validity" question. (This is the concern that a strong preemption rule would displace contract provisions that were essential to the enforceability of contract rights.) The proposal affects only state laws that require certain disclosures, and treats a failure to make the disclosures as a "violation" subject to some sanction.

By contrast, if there is a state with common law or statutory rules that would require a creditor to describe any prepayment penalty in the contract in order to collect it, the proposal would not preempt such rules in any way. In such a case, or in any case where the creditor thought it necessary or desirable to include contract detail beyond the TIL disclosures, the additional contract language would be permissible (subject to any regulation of the Federal Reserve Board as to placement and format).

In sum, this recommendation seeks to accomplish a broader, yet more rational, preemption policy than the present law, or one that minimizes duplicative disclosures, preserves the parties' freedom of contract, and retains the authority of the states to regulate aspects of credit transactions that TIL does not reach. We emphasize that the proposal allows the states to enforce state disclosure laws that are the same as TIL.

CIVIL LIABILITY PROVISION

The 1968 Truth in Lending Act (TILA) was enacted to provide meaningful and comparable credit cost disclosure information, to foster consumer awareness of the cost of credit and credit terms, and to facilitate shopping among credit sources. The civil liabililty provision was incorporated to encourage creditors to comply with the TILA and to allow consumers to act as private attorneys general.

Prior to the legislation, less than half of the 40,000 creditors in the United States were subject to compliance examinations as provided by the federal financial regulatory agencies. Congress believed that rather than creating a federal enforcement agency, a civil liability structure should be established to encourage consumers and private attorneys to prosecute suits against non-complying creditors.

The civil liabilty provision provided that consumers could collect actual damages and civil penalties of twice the finance charge with a minimum recovery of $100 and a maximum of $1,000. Most important, a consumer's attorney could be reimbursed for reasonable attorneys' fees and court costs by a non-complying creditor.

This provision became a magnet for harassing hyper-technical lawsuits. More than 14,000 suits have been filed in federal district courts alone during the last 15 years, often based upon hyper-technical and non-substantive requirements of the TILA. The allegations often involve nothing more than technical violations of matters that do not bear on credit cost disclosures or the ability to shop for credit; they merely impose penalties on creditors unable to chart varying court interpretations.

A number of court decisions have acknowledged the non-substantive aspects of the suits, but have also assessed penalties because they are mandated under the TILA. For example, in Sun America Finance Corp. v. Williams, 442 N.E.2d 83 at 86 (Ohio App 1981), the court stated:

> (O)nce a creditor violation of Truth-in-Lending requirements is proven, liability follows absolutely and the debtor must be awarded damages ... . However much we may disapprove of this aspect of the scheme adopted by Congress, because of its oftentimes effect of working what we, as judges, perceive to be unjust results in individual cases, we nonetheless are compelled to apply the law as it has been written or as it may reasonably be construed.

To better understand the TIL litigation problem the Committee must remember that in the typical suit, the consumer has not suffered any actual damages and is usually in arrears on the debt. Therefore, the litigation is a defensive move. The typical litigation strategy is called sieve effect. Here, the plaintiff will allege anywhere from five to twelve or more violations with the hope that the case goes through the judicial sieve, i.e, a judge will agree with at least one claim.

One judge described the process as this: "Plaintiff sets forth an impressive array of tasks alleged to have been accomplished in the course of the litigation. However, the plain fact of the matter is that most of the work plaintiff did was useless. His method of advocacy could best be described as the "sieve approach," i.e., indiscriminately throwing legal gravel upon a sieve hoping that some would not filter through, never giving any hint to the Court as (to mix a metaphor) how to separate the wheat from the chaff. One of the ten claims thus hurled did turn out to be meritorious; hence his present application."(3)

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3. Kramer v. Marine Midland Bank (S.D.N.Y. 1983) 559 F. Supp. 273.

In this case the plaintiff attempted to collect $38,634.75 in legal fees. The court, after reviewing the merits of the work, reduced the award to $2,000 in fees, $612.84 in cost, and $1,000 in statutory damages.

In 1980 Congress passed the Truth in Lending Simplification and Reform Act, in part to address these problems. That Act had several objectives, which included simplification of TILA disclosures and reform of the statute to reduce litigation. Congress tried to reduce litigation by rewriting sections of the TILA that had been the focus of law suits, and by reducing the number of items upon which a credit granting institution could be sued. However, the limitations on liability are very narrow, and creditors still can be sued for the slightest variance of any of the following items:

Open End Credit - Initial Disclosure Statement

1. The conditions under which a finance charge may be imposed
2. The method of determining the balance upon which a finance charge will be imposed
3. The method of determining the amount of the finance charge
4. Where one or more periodic rates may be used to compute the finance charge, each rate, the range of balance to which it is applicable, and the corresponding nominal annual percentage rate should be disclosed
5. Identification of other charges which may be imposed
6. Where the credit is or will be secured, a statement that the security interest is, or will be taken in, the property purchased or property not purchased must be identified by item or type

7. Providing a billing rights statement
8. Complying with any provision of Section (§) 125 (Rescission)

Open End Credit - Periodic Statement

1. The amount of any finance charge
2. The one or more periodic rates used to compute the finance charge
3. The annual percentage rate (APR)
4. The balance on which the finance charge was computed, and a statement of how the balance was determined
5. The outstanding balance in the account at the end of the period
6. The date by which or the period (if any) within which payment must be made to avoid additional finance charges
7. The address to be used by the creditor for the purpose of receiving billing inquiries

Closed End Credit

1. The amount financed
2. The amount of the finance charge
3. The annual percentage rate (APR)
4. The total of payments
5. The number, amount, or due dates scheduled to repay the total of payment
6. A statement that a secure interest has been taken in the property being purchased or other property described by item or type
7. Complying with provision of Section 125 (Rescission) applicable to the transaction

The Fed has drafted the new Regulation Z in a far more logical and simplified manner. Interpretative letters have been eliminated, and a staff commentary on the regulation, which is over 100 pages in length and is updated annually, has been issued. However, lenders are still confronted with significant civil liability for any hyper-technical violation or an enforcement agency-ordered restitution for minor mathematical mistakes. There continues to be a legitimate concern about this liability. Therefore, prudent counsel have felt compelled to seek definitive interpretations of the Regulation from the Board staff.

The Board itself has recognized this problem. On April 28, 1981, Vice Chairman Frederick H. Schultz testified before this Committee that the civil liability provisions are:

> Often a major contribution to regulatory complexity ... . Although financial institutions should be expected to follow the law scrupulously, the problem with disproportionately severe penalties is that they compel the Board to articulate extremely detailed rules governing every facet of regulated conduct. In giving the requested protection, compliance for everyone is made more complex.

This testimony was presented well over a year after Congress had made modest amendments to scale down Section 130 liability. We believe that the essence of Governor Schultz's suggestion could be achieved by modifying the Act's civil liability provision.

The underlying problem has not been solved, as we can see by the number of lawsuits in federal court under the new Act. We believe that the desired simplification cannot be achieved until there is an end to the automatic imposition of civil penalties for hyper-technical mistakes or novel legal theories not foreseen by the Board, the creditor community, or Congress.

In S.1720, introduced in the last Congress, Senator Garn suggested that the better approach would be to have the courts look at the contract and disclosures as a whole and determine if they were in "substantial non-compliance" with the Act or Regulation.

We believe this to be the preferable approach. Courts should be given the discretion to review all the disclosures subject to the civil liability penalty provision and reward or deny recovery based on whether or not the transaction is in substantial non-compliance with the primary purposes of the TILA, which allows the consumer to comparison shop the cost of credit and be informed of essential contract provisions.

Our view is that the present penalty structure of twice the finance charge with a minimum of $100 and maximum of $1,000 is too arbitrary. We support Senator Garn's approach of allowing the court to impose a civil penalty of up to $5,000 depending upon the degree of non-compliance.

Since numerous TIL suits will continue to involve trivial matters, we believe the Committee should instruct the court when exercising this discretionary power, to use it in a manner to discourage litigation that wastes judicial resources. Also, when awarding attorney fees, the Committee should instruct the court that those bringing trivial suits should not be generously rewarded; but those who act as a private attorney general to prosecute egregious violations of the Act as originally envisioned by the Congress should be justly compensated.

The final amendment relates to the ability of a plaintiff to have double recovery for single violations. In many instances a violation of federal law is also a violation of state law. We believe that punitive damages should be collected only once.

This occurs because many states have enacted statutes similar or identical to the federal TIL law as part of their disclosure scheme in order to assure state enforcement authority. In some instances many of the state disclosures are based upon early drafts of the first TILA and present unique problems.

It has been a longstanding tenet of our nation's public and judicial policy that double recovery is unwarranted and that the plaintiffs should choose the law under which they wish to receive their award. This Committee, when considering amendments to the Equal Credit Opportunity Act in 1976, recognized this principle of law and prohibited double recovery. We, therefore, urge this needed reform be added to the Act.

The CHAIRMAN. Thank you very much, Mr. Hammer.

Mr. Patterson.

STATEMENT OF RICHARD P. PATTERSON, SENIOR VICE PRESIDENT, INTERFIRST BANK, DALLAS, TEX.; PRESIDENT, DEALER BANK ASSOCIATION

Mr. PATTERSON. Mr. Chairman and members of the committee, I am Richard Patterson, senior vice president of Interfirst Bank of Dallas, and president of the Dealer Bank Association. The Dealer Bank Association is a trade association of some 175 member banks from all parts of the country that are active in the public securities markets and in other securities activities in which banks are permitted to engage. The DBA appreciates this committee's invitation to participate in this important hearing.

The DBA was one of the participants in the recent meeting of the six major bank trade associations, and we endorse the unanimous industry position in favor of legislation that would permit banking organizations to offer new products and services to the public. The DBA strongly believes that new securities activities for banking organizations should be among those products.

CONGRESS SHOULD ENACT SECURITIES PROVISIONS THIS YEAR

There are several reasons for Congress to act this year on the securities provisions of the bills before you.

First, the public policy issues surrounding the securities provisions of the bills have been exhaustively discussed and studied for many years. The favorable consensus is reflected in the fact that all three bills before you contain very similar provisions that would permit banking organizations to engage in a relatively limited but important set of new securities activities.

Second, there is now widespread support, even within the banking industry, for placing many of the securities activities of banking organizations—including all of the new authority—in a separately capitalized subsidiary of the holding company, rather than in the bank itself. The separate subsidiary requirement lays permanently to rest the ancient canards—undue risk, conflict of interest, tax or regulatory advantage—that broker-dealers have used in the past as arguments against allowing banks to engage in additional securities activities.

Third, allowing banking organizations to compete in additional securities markets will produce significant economic benefits for the public. More competition will bring lower costs to the State and local governments that issue public securities—as studies have repeatedly shown, and as commonsense confirms. Additional competition in other securities markets will also bring lower costs and increased services to the customer. Banking organizations have long and productively been major participants in the capital and securities markets, and they will use this experience to compete vigorously and fairly in the additional markets the bills before you would open up.

For these reasons, the DBA supports the securities provisions of the bills before you. My written testimony states our views on the specific provisions of the bills in detail. I will only touch on the main points at this time.

As this committee is well aware, the DBA has long supported allowing banking organizations to underwrite and deal in municipal revenue bonds. The Senate has twice passed legislation permitting banks to underwrite municipal revenue bonds, and a majority of the Members of the House cosponsored such legislation in the last Congress. All of the pertinent Federal regulatory agencies, including the Treasury, the Federal Reserve Board, and the Comptroller, have endorsed legislation that would permit banking organizations to compete in the revenue bond market. The legislation is also supported by State and local governments across the country, as well as by the associations that represent them in Washington.

There is a good public policy reason, of course, for the widespread support of the entry of banking organizations into the revenue bond market. Put simply, allowing banking organizations to underwrite and deal in municipal revenue bonds would save many millions of dollars for State and local governments and their taxpayers. Numerous economic studies have shown that there would be enormous savings. Commonsense confirms this conclusion. These savings for municipal governments can be achieved, I should add, without any increased expenditure by the Federal Government. In an era of cutbacks in Federal assistance programs for State and local governments, and when the infrastructure needs of our States and cities are great and growing, it is particularly important that Congress act immediately to remove the artificial barriers that now exist to full competition in the municipal revenue bond market.

In recent years, new issues of revenue bonds have surpassed general obligation bond volume. In 1982, revenue bonds accounted for 73 percent of the overall municipal market. The archaic prohibition against banking organizations underwriting revenue bonds meant that banks were prevented, in 1982, from competing for almost $35 billion in municipal revenue bonds, about 61 percent of the revenue bond market. The exclusion of banking organizations from this huge portion of the market has left issuers of municipal revenue bonds dependent on a few broker-dealers to raise the money they need for public projects. In the revenue bond market, the 10 leading underwriters—all of whom are large broker-dealers, of course—controlled nearly half the market in 1982, up from 43 percent in 1977. By contrast, in the general obligation bond market, where banks can compete fully, the share of the 10 leading underwriters—bank and nonbank—declined from 32 percent in 1977 to 29 percent in 1982. In short, just as you would expect, the general obligation market is significantly more competitive, and less concentrated, than the revenue bond market. The bills before you would correct that situation.

DBA SUPPORTS THE MUTUAL FUND PROVISIONS

The DBA supports the mutual fund provisions of the bills before you. The mutual fund market is enormous and growing, and it provides an important way for individuals to invest in the American economy. Banking organizations are today engaged in a wide variety of activities—including providing investment advice, and selling securities as agent—that give them the expertise and experience they will need to compete safely and effectively in the mutual fund market. And since the mutual fund activities will have to be conducted in a holding company subsidiary, rather than in the bank, the regulatory scheme applicable to investment companies and their advisers today will be applicable to the bank securities affiliate under the bill. That will certainly assure fair and increased competition, and thus benefit the public.

The DBA commends the chairman and Senator Proxmire for adding to their bills a specific authorization for the bank securities affiliate to underwrite and deal in mortgage-related securities. This is a good addition to the administration's bill, and one we strongly support.

If we as a society are to meet the demands for housing at affordable rates—and, at the same time, provide increased job opportunities in the construction and related industries—we must find better ways to use the enormous resources of the Nation's capital markets to finance homeownership. One important way to do that is to allow banking organizations to be full participants in the mortgage-backed securities markets.

Historically, banks have been major players in addressing our country's housing needs. Banks and bank holding companies are major mortgage lenders and originators. In addition, banks are expressly permitted to underwrite and deal in housing revenue bonds issued by State and local governments, as well as securities issued by FNMA, FHLMC, and GNMA. These obligations are essentially pools of private mortgages, just like the instruments banks securities affiliates could underwrite and trade under Senator Garn's and Senator Proxmire's bills.

In sum, Mr. Chairman, we join the other banking associations in urging Congress to pass legislation allowing bank holding companies to offer additional products and services, and we urge in particular the securities activities contained in the bills now before you. The public policy reason for you to act is that competition by banking organizations will clearly benefit the consumer and taxpayer. You will hear from our future competition, the broker-dealers, that you should wait for this study or that case, or until you can do everything at once, or until forever. You should reject calls for further delay. The vehicle—the banks securities affiliate—is at hand. The products—municipal revenue bonds, mutual funds, mortgage-backed securities—are widely agreed upon. And the need for quick action by this committee—so that the Congress can pass legislation this year—is very clear.

Thank you. I will be happy to answer any questions you have.

[The complete statement follows:]

TESTIMONY OF RICHARD P. PATTERSON
PRESIDENT OF THE DEALER BANK ASSOCIATION
BEFORE THE SENATE COMMITTEE ON
BANKING, HOUSING AND URBAN AFFAIRS
FEBRUARY 22, 1984

Mr. Chairman and members of the Committee, I am Richard Patterson, Senior Vice President of InterFirst Bank of Dallas, and President of the Dealer Bank Association. The Dealer Bank Association is a trade association of approximately 175 banks, from all parts of the country, that are active in the public securities markets and in other securities activities in which banks are permitted to engage. The DBA appreciates this Committee's invitation to participate in this important hearing.

Our testimony today will focus on the securities aspects of three major bills before you: S.1609, the "Financial Institutions Deregulation Act", which contains the Administration's proposals; S.2134, the "Depository Institutions Holding Company Act Amendments," introduced by Senator Proxmire; and S.2181, the "Financial Services Competitive Equality Act", introduced by the Chairman. All three bills contain similar provisions that would permit bank securities affiliates -- but not banks -- to engage in additional securities activities, including the underwriting of municipal revenue bonds, the establishment of mutual funds and the sale of their shares, and the underwriting of mortgage-backed securities.

Overall DBA Position

The DBA was one of the participants in the recent meeting of the six major bank trade associations, and we endorse the unanimous industry position in favor of legislation that would permit banking organizations to offer new products and services to the public. The DBA strongly believes that new securities activities for banking organizations should be among those activities.

There are several reasons for Congress to act this year on the securities provisions of the bills before you. First, the public policy issues surrounding the securities provisions of the bills have been exhaustively discussed and studied for many years. The favorable consensus is reflected in the fact that all three bills before you contain very similar provisions that would permit banking organizations to engage in a relatively limited but important set of new securities activities. Second, there is now widespread support, even within the banking industry, for placing many of the securities activities of banking organizations -- including all of the new authority -- in a separately capitalized subsidiary of the holding company, rather than in the bank itself. The separate subsidiary requirement lays permanently to rest the ancient canards -- undue risk, conflict of interest, tax or regulatory advantage -- that broker/dealers have used in the past as arguments against allowing banks to engage in additional securities activities. Third, allowing banking organizations to compete in additional securities markets will produce significant economic benefits for the public. More competition will bring lower costs to the state and local governments that issue public securities -- as studies have repeatedly shown, and as common sense confirms. Additional competition in other securities markets will also bring lower costs and increased services to the customer. Banking organizations have long and productively been major participants in the capital and securities markets, and they will use this experience to compete vigorously and fairly in the additional markets the bills before you would open up.

For these reasons, the DBA supports the securities provisions of the bills before you. We also support those provisions of the bills that would simplify and expedite regulatory review of the establishment and operation of securities and other subsidiaries of bank holding companies. We do have comments on the specific provisions of the bills, a topic to which I will now turn.

Municipal Revenue Bonds

As this Committee is well aware, the DBA has long supported allowing banking organizations to underwrite and deal in municipal revenue bonds. The Senate has twice passed legislation permitting banks to underwrite municipal revenue bonds, and a majority of the members of the House co-sponsored this legislation in the last Congress. All of the pertinent federal regulatory agencies, including the Treasury, the Federal Reserve Board, and the Comptroller, have endorsed legislation that would permit banking organizations to compete in the revenue bond market. The legislation is also supported by state and local governments across the country, as well as by the associations that represent them in Washington.

There is a good public policy reason, of course, for this widespread support for permitting banking organizations to compete in the revenue bond market. Put simply, allowing banking organizations to underwrite and deal in municipal revenue bonds would save many millions of dollars for state and local governments and their taxpayers. Numerous economic studies have shown that there would be enormous savings. Common sense confirms this conclusion. Additional competition from banking organizations in the revenue bond market will reduce underwriting spreads by giving issuers more underwriters to choose from, and will increase the liquidity of the secondary market, by allowing more financial institutions to deal in revenue bonds -- all of which will reduce the costs state and local governments must pay to borrow money. These savings for municipal governments can be achieved, I should add, without any increased cost to the federal government. In an era of cutbacks in federal assistance programs for state and local governments, and when the infrastructure needs of our states and cities are great and growing, it is particularly important that Congress act immediately to remove the artificial barriers that now exist to full competition in the municipal revenue bond market.

It is familiar history that revenue bonds were virtually non-existent when the Glass-Steagall Act was passed, and that the absence of statutory authority for banks to underwrite and trade in all municipal revenue bonds is just an historical anomaly. Since 1933, Congress has amended Glass-Steagall at least 15 times to bring the benefits of bank competition to many issuers of public securities, including several international agencies. It is time -- it is long past time -- to allow state and local governments those same benefits.

You will undoubtedly hear from broker/dealer representatives in opposition to additional competition in the revenue bond market. Their tired old arguments should give you no pause. Banks today compete in parts of the revenue bond market without either dominating those parts of the market or driving small or regional broker/dealers out of business. The supposed undue riskiness of allowing banking organizations to underwrite revenue bonds is belied by the fact that banks can buy municipal revenue bonds for investment today, and have done so safely for many years. The hypothetical conflict of interests banking organizations will face have been analyzed and rejected as unfounded by the federal banking agencies -- and by the Senate on two separate occasions. In short, there is no good reason to keep banking organizations from full participation in the municipal revenue bond market.

To the contrary, there is a compelling public policy need to allow banking organizations into the revenue bond market right away. In recent years, new issues of revenue bonds have surpassed general obligation bond volume. In 1982, revenue bonds accounted for 73 percent of the overall municipal market. The archaic prohibition against banking organizations underwriting revenue bonds meant that banks were prevented, in 1982, from competing for almost $35 billion in municipal revenue bonds, about 61 percent of the revenue bond market. The exclusion of banking organizations from this huge portion of the market has left issuers of municipal revenue bonds dependent on a few broker/dealers to raise the money they need for public projects. In the revenue bond market, the ten leading underwriters -- all of whom are large broker/dealers, of course -- controlled nearly half the market in 1982, up from 43 percent in 1977. By contrast, in the general obligation bond market, where banks can compete fully, the share of the ten leading underwriters (bank and non-bank) declined from 32 percent in 1977 to 29 percent in 1982. In short, just as you would expect, the general obligation market is significantly more competitive, and less concentrated, than the revenue bond market. The bills before you would bring that additional competition to the revenue bond market too.

All three bills contain virtually identicial provisions relating to the underwriting and trading of municipal revenue bonds by bank securities affiliates. We suggest two changes in these provisions.

First, we think that the definition of "revenue bond" in the bills, while an improvement over the earliest versions of the Administration bill, needs to be revised. As written, the bills would permit a bank securities affiliate to underwrite a municipal revenue bond that is, under the tax code, an "industrial development bond" only (a) if the bond is presently bank-eligible (because it has a general obligation back-up, or because it is presently bank-eligible), or (b) if the bond will finance a facility of which the public body issuer will be, under the tax code, the "tax owner." As we understand it, this "tax owner" restriction would allow a bank securities affiliate to underwrite many of the larger airport, port and power issues, but not some of the smaller municipal revenue bond issues -- say, for a particular facility at a public airport. The "tax owner" restriction would thus leave broker/dealers as the exclusive available underwriters for many municipal revenue bonds. We believe that this result is undesirable as a matter of public policy.

We also think it clear that the "tax owner" restriction is inappropriate and unnecessary. The complex "tax owner" provisions of the Code are designed to govern who can depreciate the facility for tax purposes, not whether banking organizations should be allowed to underwrite the security. Moreover, these smaller issues are no riskier to underwrite than other muncipal issues, and in any event, only the bank securities affiliate, not the bank itself, would be authorized to underwrite them by the bills you are considering.

We suggest the proper resolution of this issue is to allow bank securities affiliates to underwrite and deal in all muncipal revenue bonds, including those "industrial development bonds" whose proceeds will be used for public purpose "exempt activites." A list of these activities -- established by the Congress -- is found in Section 103(b)(4) of the Internal Revenue Code, a copy of which is attached to this testimony. The list includes such things as airports, docks, wharves, municipal sports facilities and convention or trade show facilities, as well as facilities for furnishing water to the public for sewage or solid waste disposal. Bank securities affiliates should be allowed to underwrite these bonds regardless of who the "tax owner" of the facility is. (For the convenience of the Committee, we have attached a "Technical Addendum" to this testimony containing the revisions necessary to accomplish this and the other changes we suggest.)

Second, we believe that the provisions governing sales to the bank's portfolio where the bank securities affiliate is a "principal underwriter" should be clarified. The existing language might be read to require the outside directors of the bank to approve each acquisition separately before it is made. That sort of requirement would put an unnecessary burden on the bank and its outside directors. Securities firms are not subject to such a requirement, and, in light of the other provisions of the bills you have before you, as well as the regulations of the banking agencies and the Municipal Securities Rulemaking Board, there is really no need to impose any prior approval requirement on banks. But, if outside director approval is to be required, the bill should clearly permit the directors to approve purchases by establishing (and periodically reviewing) standards or guidelines for acquisition (*e.g.*, rating, location of issuer, size of issue), rather than leaving ambiguous whether specific approval is needed each time. Proposed statutory language is provided in the Technical Addendum.

Mutual Funds

The DBA supports the mutual fund provisions of the bills before you. The mutual fund market is enormous and growing, and it provides an important way for individuals to invest in the American economy. Banking organizations are today engaged in a wide variety of activities -- including providing investment advice, and selling securities as agent -- that give them the expertise and experience they will need to compete safely and effectively in the mutual fund market. And since the mutual fund activities will have to be conducted in a holding company subsidiary, rather than in the bank, the regulatory scheme applicable to investment companies and their advisors today will be applicable to the bank securities affiliate under the bill. That will certainly assure fair and increased competition, and thus benefit the public. We have only minor technical comments on this portion of the bills at this time; these are in the Technical Addendum.

Mortgage-Related Securities

The DEA commends the Chairman and Senator Proxmire for adding to their bills a specific authorization for the bank securities affiliate to underwrite and deal in mortage-related securities. This is a good addition to the Administration's bill, and one we strongly support.

It is clear that the "securitization" of the mortgage market is coming very fast, and that this is a desirable result that Congress should facilitate. If we as a society are to meet the demands for housing at affordable rates -- and, at the same time, provide increased job opportunities in the construction and related industries -- we must find better ways to use the enormous resources of the nation's capital markets to finance home ownership. One important way to do that is to allow banking organizations to be full participants in the mortgage-backed securities markets.

Historically, banks have been major players in addressing our country's housing needs. Banks and bank holding companies are major mortgage lenders and originators. In addition, banks are expressly permitted to underwrite and deal in housing revenue bonds issued by state and local governments. These obligations are essentially pools of private mortgages, like the instruments banks securities affiliates could underwrite and trade under Senator Garn's and Senator Proxmire's bills.

There are differences in the language used in the two bills, though the purposes of the bills seem quite consistent. We provide the Committee in our Technical Addendum with statutory language that we think would work well. Whatever language the drafters finally settle upon, we think the bill or the Committee Report should make it clear that the reference to mortgages includes deeds of trust or other security interests in real estate used in some states, as well as second mortgages, and that the assets underlying the securities can include loans for mobile homes, condominium and cooperative residences, as well as assets incidental to mortgage loans (e.g., funds awaiting distribution or property acquired by foreclosure).

Transfer Of Securities Activities

All three bills require any bank whose holding company engages in new activities through a bank securities affiliate to transfer certain existing bank securities activities to the affiliate. In the interest of achieving a consensus and getting legislation through as promptly as possible, the DBA does not oppose the transfer requirement. We do suggest, as a practical matter, that banks be given two years, rather than the one year now in the bills, to make the transition. A longer transition period will be of particular importance to smaller institutions.

Among the activities that have to be transferred out of the bank to a bank securities affiliate is providing brokerage services to the public. We do not oppose the requirement that public bank discount brokerage activities or "full-service" brokerage activities (i.e., execution plus advice services) be moved to a bank holding company subsidiary. But the language used in the bills might be interpreted to require the transfer of other "as agent" activities that are related to services (such as trust or custody services) that the bank will continue to perform for its customers. There is no need for these activities to be transferred to the securities affiliate. Revised statutory language can be found in the Technical Addendum.

Other Matters

Finally, the DBA supports the reforms of Federal Reserve Board procedure that would be made by the bills. Since the bank securities affiliate will be subject to SEC and NASD regulation, it is unnecessary to grant the Board any extensive regulatory powers over the affiliate. We also support the elimination of the "proper incident" requirement from Section 4(c)(8) of the Bank Holding Company Act (which all three bills would do), and the direction to the Federal Reserve Board (in Senator Garn's and the Administration's bills) promptly to add a "activities of a financial nature" to the list of permissible activities for bank holding company subsidiaries.

Conclusion

We join the other banking associations in urging Congress to pass legislation allowing bank holding companies to offer additional products and services, and we urge in particular the securities activities contained in the bills now before you. The public policy reason for you to act is that competition by banking organizations in the revenue bond, mutual fund, and mortgage-backed securities markets will clearly benefit the consumer and taxpayer.

You will hear from our future competition, the broker/dealers, that you should wait for this study or that case, or until you can do everything at once, or until forever. You should reject calls for futher delay. The vehicle -- the bank securities affiliate -- is at hand. The products -- municipal revenue bonds, mutual funds, mortgage backed securities -- are widely agreed upon. And the need for quick action by this Committee -- so that the Congress can pass legislation this year -- is very clear.

Thank you.

February 22, 1984

TECHNICAL ADDENDUM TO TESTIMONY OF RICHARD P. PATTERSON ON BEHALF OF THE DEALER BANK ASSOCIATION

This Technical Addendum contains proposed statutory language to implement the legislative suggestions of the Dealer Bank Association concerning S.1609, S.2134 and S.2181.

Scope of Revenue Bond Underwriting Authority

S.1609: At page 16, line 21, strike everything after "(ii)" through page 17, line 3, and insert the following:

> "such industrial development bonds are part of an issue substantially all the proceeds of which are to be used for an activity described in Section 103(b)(4) of the Internal Revenue Code of 1954, as amended;"

S.2134: Same change at page 15, lines 7 through 13.

S.2181: Same change at page 22, lines 23 through page 23, line 5.

Sales of Securities By Bank Securities Affiliate to Bank

S.1609: At page 23, strike lines 1 through 5 and insert the following:

> "not apply to the purchase of securities having characteristics established or confirmed within twelve months prior to the date such securities are initially offered

> for sale to the public, by a majority of the directors of the bank who are not officers or employees of the bank or any affiliate thereof."

S.2134: Same change at page 27, lines 11 through 15.

S.2181: Same change at page 29, lines 14 through 18.

Mutual Fund Provisions

S.1609: At page 17, strike lines 4 through 16, and insert the following:

> "(B) organize, sponsor, operate, control, provide investment advice to, or underwrite, distribute, or sell the shares of an investment company, as such term is defined in section 3 of the Investment Company Act of 1940, as amended (15 U.S.C. § 80a-3); and"

S.2134: No change (language above taken from S.2134, page 15, lines 16-21).

S.2181: At page 23, strike lines 6 through 18, and insert language above as clause "(II)."1/

1/ If the existing language of S.2181 is retained instead, the cross-reference on page 23, line 12 to "subparagraph (B)" should be to "subparagraph (II)", and "(2)" should be inserted between "and" and "any" on the same line.

Mortgage Backed Securities

S.1609: At page 17, before "(iv)", insert the following:

> "(C) deal in or underwrite securities directly or indirectly representing or secured by interests in real estate or residential mortgage loans."

S.2134: At page 15, strike lines 14 and 15, and insert the following:

> "(ii) dealing in or underwriting securities representing, directly or indirectly, interests in real estate or residential mortgage loans;"

S.2181: At page 23, strike from lines 19 through page 24, line 10, and insert language proposed above for S.1609 as clause "(III)."2/

Time For Transfer Of Securities Activities

S.1609: At page 14, line 9, strike "one year" and insert "two years."

S.2134: Same change at page 16, line 4.

2/ If the existing language of S.2181 is retained instead, a cross-reference must be added for "the above requirements" at page 24, line 5.

S.2181: Same change at page 20, line 10.

Transfer of Brokerage Activities

S.1609: At page 15, starting in line 1, strike "purchasing and selling securities and stock as agent", and insert the following:

"and engaging in the public brokerage business."

S.2134: At page 16, strike line 16 and insert the language above.

S.2181: At page 21, starting in line 2, strike "purchasing and selling securities and stock as agent," and insert language above.

Glass-Steagall Extension

S.1609: No change.

S.2134: Strike Section 11, at page 20, line 13 through page 21, line 2; and strike Section 13, at page 21, line 14 through page 22, line 23; and re-designate sections accordingly.

S.2181: No change.

Limitation On Federal Reserve Board Authority

S.1609: At page 13, strike line 19 (after "subsection") through line 21, and insert the following:

> "or that is prohibited to an affiliate of a member bank under Section 20 (12 U.S.C."

S.2134: At page 10, lines 17 through 19, make comparable change to that stated above.

S.2184: At page 18, lines 4 through 6, make comparable change to that stated above.

The list of exempt activities contained in I.R.C. § 103(b)(4) is as follows:

(A) projects for residential rental property if at all times during the qualified project period--

(i) 15 percent or more in the case of targeted area projects, or

(ii) 20 percent or more in the case of any other project,

of the units in each project are to be occupied by individuals of low or moderate income,

(B) sports facilities,

(C) convention or trade show facilities,

(D) airports, docks, wharves, mass commuting facilities, parking facilities, or storage or training facilities directly related to any of the foregoing,

(E) sewage or solid waste disposal facilities or facilities for the local furnishing of electric energy or gas,

(F) air or water pollution control facilities,

(G) facilities for the furnishing of water for any purpose if--

(i) the water is or will be made available to members of the general public (including electric utility, industrial, agricultural, or commercial users), and

(ii) either the facilities are operated by a governmental unit or the rates for the furnishing or sale of the water have been established or approved by a State or political subdivision thereof, by an agency or instrumentality of the United States, or by a public service or public utility commission or other similar body of any State or political subdivision thereof,

(H) qualified hydroelectric generating facilities,

(I) qualified mass commuting vehicles, or

(J) local district heating or cooling facilities.

For purposes of subparagraph (A), the term "targeted area project" means a project located in a qualified census tract (within the meaning of section 103A(k)(2)) or an area of chronic economic distress (within the meaning of section 103(A)(k)(3)). For purposes of subparagraph (E), the local furnishing of electric energy or gas from a facility shall include furnishing solely within the area consisting of a city and 1 contiguous county.

The CHAIRMAN. Thank you, Mr. Patterson.

Gentlemen, we appreciate your testimony and I will repeat, so there is no doubt, your entire statements will be placed in the record as if read.

Gentlemen, we have a lot of conventional wisdom around Washington. The conventional wisdom right now around town is that there's no chance for passage of the bill. This is an election year and we hear that over and over again. Well, I would remind everyone that in 1980 the Financial Institutions Deregulation Monetary Control Act passed in an election year, a Presidential-election year. My bill passed in 1982 about 5 or 6 weeks before a very important election.

So I don't necessarily believe conventional wisdom around Washington, particularly conventional political wisdom, which more often than not turns out to be wrong. But people in Washington like to have certain rules by which they operate and one of them is that we don't do anything in an election year.

WHAT HAPPENS IF CONGRESS DOESN'T PASS THIS LEGISLATION IN 1984?

Despite the fact I don't believe that and believe there is a good chance for passing legislation this year, my first question to you would be: What if the conventional wisdom is right for once and we can't do anything—nothing happens, the status quo? What is your opinion, Mr. Olsen, of the effects on the marketplace if we make no decision this year?

Mr. OLSEN. Senator, I think that it would depend on which marketplace. I think in the more competitive markets you will find the effects more immediately. In the smaller towns, it will be more gradual, but that doesn't mean it won't happen.

I think the inequities in the competitive market are quite clear and I think that 1 year from now we would see a much more adverse circumstance than we have now, the degree of which simply will be a function of the specific market.

The CHAIRMAN. Mr. King.

Mr. KING. Well, in our opinion, this would weaken the whole banking system. I think at that point we would hope there would be a reasonable amount of consideration for a moratorium, until such time as Congress can take action.

The CHAIRMAN. Well, I have opposed a moratorium and that brings up another question. Moratoriums have almost universally been used by the Congress of the United States to delay, not to use as a period of rational contemplation and consideration, in coming up with answers at the end of that moratorium.

But beyond using it as a reason for delay and not facing up to some difficult decisions, do you think a moratorium could possibly be fair to all of the nonbank banks who are already in certain services. They don't say it publicly, but if I were one of them, I think a moratorium would be great—freeze out all the new competition while they roll merrily along.

So do you feel a moratorium would be helpful under those circumstances?

Mr. KING. I do think it would be helpful under those circumstances, providing that we can close that loophole, at least until

Congress can make a decision as to whether it wants nonbank charterings to continue.

The CHAIRMAN. You close the loophole for new competitors but what about those who are already in it? Doesn't that give them a significant advantage, even a 6-month advantage, to continue to penetrate the marketplace with no new competitors, no new bank competition, and no new nonbank bank? I think that would be a pretty good deal if I was one of those.

Mr. KING. I would have to agree with you.

The CHAIRMAN. Well, then, I will get back to my question. Why do you support a moratorium if you agree with me?

Mr. KING. Well, at least it would stop further erosion as far as more nonbank banks getting into the marketplace.

The CHAIRMAN. Yes, it would do that, and it would certainly help those who already have not just their head but maybe their whole body in it.

Mr. KING. Don't misunderstand me. We prefer legislation to close that loophole now rather than a moratorium. The moratorium would simply be a backup.

The CHAIRMAN. Mr. Nicholson, a lot of people argue that banks had a very good year in 1983, they were profitable, they've had greater earnings opportunities than in a long time, and therefore there's no need to change. What is your response to that?

Mr. NICHOLSON. Senator, I'd have to agree that some banks had a good year in 1983. There a number of banks, however, that did not have such a good year. I would also respectfully submit that in 1983 the level of chargeoffs by banks were the highest they have been for a numer of years as a result of the recession we have just been through and I think you will find uniformly when you see the annual reports of the banking industry that the net interest margin, the difference between what they pay for funds and what they can charge for funds, has significantly narrowed. It has narrowed because last year we were given a number of liability powers, the ability to attract deposits, for which we now pay high rates of interest, and we do not have the corresponding asset powers, the ability to invest those funds, that go along with those liability powers. And to maintain our margin spread, and to maintain our profitability, we need to have those powers.

The CHAIRMAN. Mr. Pistor, what do you think would be the results of no action this year?

Mr. PISTOR. First of all, Senator, I'm sure that your comment about profitability of banking did not apply to Texas in the past year. Historically, we have been doing well and we expect to be doing well, again in the future. But I think the saving factor is that the dynamics of the marketplace are growing each day and, as recovery grows, it becomes clearer and clearer to those of us in the marketplace that our principal nonbank competitors are hard at work.

I was just told the other day by Bill Kennedy, as a matter of fact, that Sears Roebuck is floor planning car dealers in Pine Bluff, Ark. So the encroachment continues.

The CHAIRMAN. But they haven't started selling cars on the floor with their clothes and so on yet?

Mr. PISTOR. No, not today, but the fact does remain that there is no way to stop the marketplace. The marketplace will continue to be expressive and as long as we're constrained from it, we simply lose the opportunity for market share.

It seems to me that that is probably the most fundamental point that could be made. We lose market share and lose our customers gradually, although the process takes place underneath the surface, and just because it's not completely visible at the moment doesn't mean that the nonbanks are in any kind of a moratorium. It means that we're simply held from being competitive and as we lose market shares you really have a diminishment of the profitability of the banks. In the long run, it means there will be less competition in the marketplace overall.

So I can't speak strongly enough to the urgency of proceeding because there is no moratorium on the marketplace.

STATES ARE AWARE OF THE CHANGING MARKETPLACE

The CHAIRMAN. Mr. Hammer, let me change the question just a little bit. This marketplace changes rapidly and it will continue to do so regardless of what we do—that is the driving force. I'm glad it is and I'm glad we have an economy in this country that is driven by people who have innovative and creative minds trying to figure out ways to better serve their customers. But is it your feeling that if Congress does not act that the States will?

We have a report of a commission in New York. We certainly have the South Dakota situation, Washington State, Delaware, and others. It appears to me that some of the State legislatures around this country are more aware that there is a changing marketplace than the Congress of the United States. And would you expect that if Congress is not willing to address these problems, that we would have a considerably increased activity in State legislatures with a hodgepodge of policy decisions across this country rather than having a national policy?

Mr. HAMMER. Yes, very definitely, Senator. I think the events of the last several years just underscore that sentiment. "Hodgepodge" is the exact word, as a matter of fact. Each State passes its own rules which allows some State banks to do one thing and then you go to the Federal Reserve and the member banks can't do it and a nonmember can, and you spend more time listening to lawyers than you do worrying about serving your customers.

We are in a national financial market. I think that has been made evident. I think really that's the position both Mr. Olsen and Mr. Pistor are making, which I agree with wholeheartedly, and it seems to me anything we can do in terms of getting common rules of the game from Washington would be very important.

The CHAIRMAN. Mr. Patterson, let me play the devil's advocate for a moment on the other side. Merrill Lynch has had some rather significant problems with its annuities programs that adversely affected their 1983 earnings. American Express has had widely publicized problems with the Firemen's Fund affecting their earnings, and there are other difficulties in some of the very areas that banks want to expand in.

What do you foresee if you are granted some of these new authorities with admitted problems by some of the nonbank banking organizations who are involved in them? Does that worry you? Do you have some concerns about it?

Mr. PATTERSON. No, I don't. I really feel that banks already have experience in all of the three fields that these products fall into—insurance, real estate, and securities—and that we can very definitely offer increased competition in these fields. I think this would be healthy for the consumer on a nationwide basis.

The CHAIRMAN. Thank you. My time is up.

Senator Proxmire.

Senator PROXMIRE. Mr. Chairman and gentlemen, I apologize for having been absent during part of your testimony. I had to go to the floor, unfortunately, and I regret it very much. I had a chance to read all of your statements and it was good to hear your very fine presentations.

I'd like to ask Mr. Olsen and Mr. King this question. Many Members of Congress are reluctant to act on the controversial banking legislation in an election year. You know that lots of people are very deeply involved emotionally and otherwise in this legislation. Moreover, if we did act, it's extremely doubtful we would approve all of the sweeping new powers for bank holding companies suggested in the Treasury bill.

For that reason, some have argued that the banking community would be best served if this entire issue were postponed until next year. During the interim, the legal separation between banking and other financial services would continue to erode, and under this scenario Congress would ultimately be forced to rectify the changes taking place.

Mr. Olsen, what's your reaction to that strategy of delay?

Mr. OLSEN. As the chairman reminded us just a few minutes ago, banking legislation seems to happen more often in an election year than not. The Monetary Control Act was passed in 1980 which was also a Presidential election year.

Recognizing the fact that even in election years——

Senator PROXMIRE. That was my bill.

Mr. OLSEN. That's right. Recognizing that in an election year we're well aware that there aren't many Members of the Congress that say: "Gee, what should I do for the banks before I go home for election day," Nevertheless, history suggests the possibility that legislation could be enacted.

We think that the problems are important enough that they ought to be dealt with this year. There never seems to be a good time to address controversial questions, but I think that they ought to be addressed now. We support the package that has been presented and that we've outlined.

Senator PROXMIRE. Mr. King.

Mr. KING. Senator Proxmire, we feel somewhat the same way. We feel that there should be legislation this year and we would like to see it this year. If it should occur that there is no legislation, then we would want to support a moratorium so that we do not have further erosion, until such time as Congress can act on the problems at hand.

Senator **Proxmire**. Let me just interrupt. Mr. Olsen, you didn't mention a moratorium. If we do not get legislation, would you support a moratorium, too, or not?

Mr. **Olsen**. No, sir; we do not.

Senator **Proxmire**. All right. Mr. King, go ahead.

Mr. **King**. It may be possible, because of the many issues that are involved in Senator Garn's legislation, that your legislation might be more acceptable inasmuch as it is not quite as controversial. We see your particular legislation as closing the nonbank loophole, which we would support. We do not think that it gets involved with such controverisal issues as interstate banking or sanctioning regional banking. It does not mix in interest on checking, and other things that could become very controversial down the line. It also does open the door to additional powers. Consequently, we could support that bill, on that premise.

Senator **Proxmire**. Mr. Olsen, Mr. King answered the second part of my question which you didn't have an opportunity to answer, so let me ask you this. How urgent to you is it for Congress to pass legislation this year? Would you be prepared to support a more limited bill—Mr. King indicated he would—if it did not provide you with all the new powers you are seeking?

ABA HOPES FOR PASSAGE OF TOTAL BILL

Mr. **Olsen**. We are aware of the fact that the ultimate product may not be what is on the table right now, but we think that all the powers that we're talking about are important for the banking industry. Each day we don't act, a part of the market slips away. And as Mr. Pistor pointed out, that's a very important problem. I think it's particularly true in smalltown banks because we are still the foundation of strength in the financial services for the small towns. So I think it's important that we act now on the totality of the bill.

As the legislative process goes on, the ABA has demonstrated in the past that we can get together and reconsider a different position, but we are asking for support of the powers.

Senator **Proxmire**. I understand you want the total bill.

Mr. **Olsen**. Yes.

Senator **Proxmire**. And I respect that and I think there's great wisdom in that perhaps, but if you cannot get the total bill and perhaps not get exactly what you want but get much of it, would you support whatever we can get?

Mr. **Olsen**. Well, we'll certainly consider whatever looks like it's going to pass. We don't have any hesitation to get together quickly for that purpose. But to try to define what that would be, I think would be premature.

Senator **Proxmire**. Now you recommended that bank holding companies be allowed to make equity investments in real estate development projects.

Mr. **Olsen**. That's correct.

Senator **Proxmire**. A study, prepared for the ABA by Arthur Young, discusses the pros and cons of banks expanding into new activities. In assessing the profit opportunities in real estate development, the study observes, and I quote: "Construction financing may be used as a lever to obtain an equity position in joint ventures with developers."

How can construction financing be used as a lever to get a bank in on a real estate development project?

Mr. OLSEN. Well, the banks, as you know, are in many cases the source of construction financing. Interim construction financing, in particular, has been an important banking activity for a long time and it is through that involvement that we are often made aware—in fact asked to comment on—the validity or the potential profitability of a real estate project, and that's the entree we have to participate.

Senator PROXMIRE. What does leverage mean?

Mr. OLSEN. As it is used in that context, I assume it means that that's what gets us into the business or it gets us an opportunity to look at participating in that project.

Senator PROXMIRE. Mr. King, what's your reaction to the proposal to establish a consumer bank?

Mr. KING. We're absolutely opposed.

Senator PROXMIRE. You're opposed?

Mr. KING. Yes.

Senator PROXMIRE. Why?

Mr. KING. A consumer bank opts its way out from underneath the Bank Holding Company Act. They have all the opportunities of any bank, with the exception of making unlimited commercial loans as I understand it, and they can actually branch in States where the laws bar or limit branching or holding company expansion.

Senator PROXMIRE. Let me ask you about branching. Some have suggested that Congress deal with the branching issue this year along with product deregulation. What's your position on this?

Mr. KING. We oppose interstate banking.

Senator PROXMIRE. Does the bank industry speak with one voice on this issue? Should we be trying to resolve this in this year?

Mr. KING. I don't think the banking industry——

Senator PROXMIRE. Maybe Mr. Olsen can tell us if they do, having heard from the Independent Bankers. How about the ABA?

Mr. OLSEN. It will come as no surprise to you that bankers have different opinions on what branch banking, or interstate banking, ought to look like. The six banking trade associations met in January and talked about the priority of legislation and we agreed that the legislation for new products and services ought to be the priority. It is our belief that a legislative package that includes interstate banking provisions could not succeed because of the differences of opinion within the industry.

So while we are not united in our opinion as to what ultimately ought to be the interstate banking laws, we are united in our opinion that it ought not be part of the bill.

I would ask any of the other participants here to speak to that if he would like.

Senator PROXMIRE. Well, Fergus Falls is not exactly New York, but at the same time you do represent the ABA. My conclusion would be that Mr. King speaks for the smaller banks, the independent banks, and you speak for the bigger banks. Is that an unfair conclusion on this issue?

Mr. **Olsen**. Well, 90 percent of the banks in the American Bankers Association are of $100 million or less, so we speak for community banks as well as large banks.

Senator **Proxmire**. Have you polled them on this issue?

Mr. **Olsen**. The ABA position on the issue has been consistent over the years. We supported the McFadden Act and we supported the Douglas amendment at the time they were passed, and that position hasn't changed.

Now there are certainly people within the ABA—in fact, many of the people here are ABA members also—who may have a different position. And so what we have done is address the question as it impacts this legislation. We've looked at it and said that's a question that ought to be postponed until we have settled the questions of what is a bank, who can own it, and what products it should have.

Senator **Proxmire**. Did I understand you to say that you still support the Douglas amendment?

Mr. **Olsen**. That's the position of the ABA.

Senator **Proxmire**. The ABA still supports the Douglas amendment?

Mr. **Olsen**. Yes, sir.

Senator **Proxmire**. Well, that's the position of Mr. King too, I think.

Mr. **Olsen**. That's correct.

Senator **Proxmire**. So you're against interstate branching?

Mr. **Olsen**. That is the position that the ABA has taken.

Senator **Proxmire**. Very good. Mr. Olsen indicated—and some of you other gentlemen may have different opinions on that. Mr. Pistor, would you like to speak on that?

CENTRAL ISSUE IS PRODUCT DEREGULATION

Mr. **Pistor**. It's not a different opinion. It's one that underscores Mr. Olsen's comment, that the importance, I think, of this panel's testimony is that as a voice we are saying that the central issue here is product deregulation first. It is a priority issue, a sequencing issue, rather than an either/or, or some composition of it. The total deregulation package obviously includes product and place, but as I have tried to sometimes parochially say, it doesn't make much sense for me to chase an invisible State boundary line with an inferior product. I think that the product line is essential first, and the group here is saying that even though, as in our case, the Association of Reserve City Bankers, according to our statement of principles, we would support the ultimate reduction of geographical boundaries. We would like to pull that back, subordinate that position in this legislation now. We think it's very important to remove that particular controversial issue of place deregulation from this legislation, acknowledging that the Congress does need to do it as soon as possible, but it's just a first-things-first issue.

Senator **Proxmire**. My time is up. Thank you, Mr. Chairman.

The Chairman. Let me just make one quick comment about the dialog between Senator Proxmire and Mr. Olsen about whether he would accept a so-called smaller bill. As I said in my opening remarks and said many times, we start the process and neither mine, or Senator Proxmire's bill, or a merger of them is going to pass in their present form. They are before the committee for the purpose of holding discussions and I would expect that if we are able to pass something this year, which I think we can, it would not be as encompassing as either one of our bills. There would have to be compromise.

Senator Heinz mentioned that we certainly don't want to go to any one group and please them. Well, that's not possible. Believe me, in the process I've been through in the last 4 or 5 years, it's simply not possible. If any one group thinks it's a wonderful thing, the other players can kill it. Even if we wanted to single out the bankers or the securities people to do a bill in favor of them, it's not possible. It's simply that everybody has got to hold their nose and say I really don't like it but I'll accept it. That's the only way to get it through. People are too sophisticated, too smart, and they can't be hoodwinked. I just want to make a point that with all the discussion about the so-called core bill we hear the Chairman of the Fed talk about, that may all take place, but not yet. I will not preside over this committee and prejudge before the hearing. All of you have heard me say that many times. That's why a lot of the provisions I put in bills are very controversial, because they deserve to be in the light of day where everybody can consider them.

I'm not willing to consider any changes in the bill yet until the hearing process is completed. Nobody is suggesting that here. I just wanted to throw that in, that we want testimony from all sides and, believe me, we'll hear a lot of different testimony than we're hearing from you gentlemen today, but people are entitled to not have it prejudged. So we will go through the initial eight hearings, which may prompt additional hearings to get more specific information on a certain part, and then when that is completed, we will start talking about what can be passed and what can't and what is reasonable.

I told the Chairman of the Fed that, I said: "Hey, you go around talking about a poor bill, but don't prejudge what you or someone else thinks ought to be in it until we've had the opportunity to hear all the witnesses on all the sides of it."

So it isn't a question that there won't have to be changes. There will be. It isn't a question of whether it will be a smaller bill than what is before us. It probably will be. There's no doubt about that. But we're not going to prejudge it. Otherwise, we're going through a charade of inviting witnesses from all over the country to testify on something that's already been judged. Everything is out on the table and that will continue until everybody has had their day in court and then we will start addressing what is possible or not possible to get through this year.

Senator Hecht.

Senator HECHT. May I second that very fine speech of yours, Mr. Chairman. It's very well put.

To the panel, are you suggesting that banks will have to adapt the holding company structure and start dealing in insurance, real estate, and securities in order to survive in the future and avert widespread bank failures? Are you in agreement on that or not?

Mr. Patterson.

Mr. PATTERSON. Well, I don't know that any of us are suggesting that the alternatives are massive failures here. What we're saying, in order to protect our viability as financial institutions in the marketplace, we absolutely have to have some remedial action here with respect to our products and services. And the beneficiary really is the public and the beneficiary also will be our stockholders through more viable institutions earningswise.

Senator HECHT. Mr. Hammer, do you agree with that?

Mr. HAMMER. Yes; we would agree with that concept, Senator, in that the various operations would then be independently capitalized and could be examined according to standards of that particular industry are.

Senator HECHT. Mr. Pistor.

Mr. PISTOR. Yes; Senator, we would agree, thinking back to your initial opening statement about the concern about concentration. We feel that deregulation is very important and very urgent in order to avoid concentrations. We would think that the tendency might be, if banking is not deregulated, that the nonbanks would continue to enlarge their position in the marketplace and hence the concentration will build up on the other side. In fact, there could even be a detrimental effect where banking no longer is an attractive line of business and more and more banks will get out of it. So you will have, in effect, fewer banks so that maybe there would be a little more concentration among the ones that are left. But the real problem is the concentration and leadership in the industry will be over on the nonbank side.

Senator HECHT. Mr. Nicholson.

DRAMATIC CHANGES COMING FOR FINANCIAL SERVICES INDUSTRY

Mr. NICHOLSON. Senator, it seems to me that the thrust is we are trying to respond to the needs and desires of our customers, the American consumer, and that the financial services industry is changing not dissimilarly to the way the grocery business changed. A number of years ago there was a green grocer, a baker, a butcher, and they all had separate shops, but they are all now in one place. And through the innovation of some companies not regulated by the Bank Holding Company Act, that has happened in the financial services industry and we respectfully ask for our ability to serve our customers with more asset powers.

Senator HECHT. There's 14,500 commercial banks in America today. If this bill were enacted in its entirety, how many banks do you think we would have in 10 years? I'm following through on what you just said.

Mr. NICHOLSON. Senator, it would be presumptuous for me to answer that. I can only respond as to my company. As I said, I have 22 banks in my company, one of which is a relatively large one; the other 21 are under $100 million in assets, which is 90 percent of the ABA. My guess is that in my company we would respond in the large bank relatively soon; in the other ones, we would do it as we expanded into the market and saw the opportunities as we gained some experience. We would walk before we would run, to answer your question.

Senator HECHT. Mr. King, how do you feel about it?

Mr. KING. Senator, we seem to have had quite a bit of deregulation in the area that costs us money. We haven't had much deregulation in areas that might make us some money.

Senator HECHT. Mr. Olsen.

Mr. OLSEN. A couple of responses, Senator. If I may, I'd like to go back to the question that you asked in your opening statement because that question speaks to the heart of what I see as the impact of this whole deregulatory process.

You were asking what happens to the local entrepreneur in the event of a continued deregulatory environment. We have a situation going in Fergus Falls right now which speaks to that. One of our major private employers burned to the ground in December. There are three banks in the town and the three banks are being asked to assist. It is clear, both to the owners of the business and to the community that only the banks can respond to keep that business alive. The insurance companies can't; the securities industry can't; the other providers and the nonbank banks can't. But if banks remain at a competitive disadvantage vis-a-vis nonbanks, it will become increasingly difficult to continue to provide the financial services our community needs.

Now with respect to the question that you asked as to what happens to the 14,500 banks in that kind of environment, I thought about that quite a bit and it is my belief that it is not the expansion of service opportunities that will close small banks or force small banks to merge. As I'm sure you are aware, a lot of small banks are already providing a number of services such as insurance, and that seems to be inverse to the size of the community. The smaller the community, the more apt the bank is to provide a variety of services. I don't think that expanding the products and services banks can provide will lead to consolidation of the banking industry.

Senator HECHT. How big is the bank which you're the head of?

Mr OLSEN. $29 million in assets.

Senator HECHT. Here's my next question. I'm going to let you answer it first. Are all banks capable of this product diversification?

Mr. OLSEN. I think, Senator, that not all banks will offer all of the products. Certainly, as we look at the new options, there are many of them that we simply would have no interest in. The most obvious example would be insurance underwriting. A bank our size will have no interest whatsoever in pursuing something like that.

But the problem is not just how do we meet our own local market now, but it's being able to react to whatever that market is going to look like 5 years from now. So we just need to have the ability to react to the market, as Senator Garn suggested. It is the market that will determine what is necessary and we want to have the ability to meet that market.

Senator HECHT. But let's get down to the specifics. What would you like to engage in right now specifically for your bank, $29 million?

Mr. OLSEN. We are in the insurance business; I would think that the next thing we would do would be in the real estate brokerage business. Beyond that, we would have no immediate plans to expand our services.

Senator HECHT. How would you get into the real estate brokerage business?

Mr. OLSEN. In our case in Minnesota, we would make application for a broker's license and then begin from there.

Senator HECHT. What would the builders do then? Would you want equity position?

Mr. OLSEN. There are three banks and two savings and loans in Fergus Falls. The mortgage market is competitive even beyond that. We have at least one real estate firm that will offer mortgage packages.

If we should suggest that we were going to make an equity position as part of our participation, they'd walk across the street very quickly. We are conscious of the fact that our customers have options. If there was even a hint in Fergus Falls that we were requiring something like that, we would lose a good share of our market. It's the competitive pressures that would see to that.

Senator HECHT. What would the real estate people say in Fergus Falls if you can offer better financing than they could offer?

Mr. OLSEN. I'd love to be faced with that option. Currently, they're telling us just the opposite, that they can get a better deal someplace else for one reason or another. I think if we were providing a very competitive mortgage option, we would be doing it for anybody that is in the real estate brokerage business. It would be lunacy for us in our market to try to offer a special package just for people doing business with us.

Senator HECHT. Let's talk about the real estate. Your $29 million footing, what percent of your loans are in real estate?

Mr. OLSEN. In real estate, 50 percent; in residential real estate, 40 percent.

Senator HECHT. What terms basically? How many years duration?

Mr. OLSEN. Currently we're offering mortgages with a 20-year amortization, and in most cases we are offering them with an adjustable feature at the end of 2½ years. We are also participating in the secondary market, so we're selling our mortgages through a mortgage banker. There is a wide variety of terms available depending on the needs of the customer.

The options available to mortgage customers are expanding very rapidly.

Senator HECHT. My time is up. Thank you.

The CHAIRMAN. Senator Heinz.

Senator HEINZ. Mr. Chairman, thank you very much.

Gentlemen, just to return in a sense to the same question that Senator Garn and Senator Proxmire asked you regarding the accuracy of the conventional wisdom, if, for example, the conventional wisdom is right, you've all stated that you support closing the so-called nonbank bank loophole. Let the record show that everybody's head more or less went up and down.

Mr. PATTERSON. Our association does not have a position on that.

CLOSING OF THE SO-CALLED SOUTH DAKOTA LOOPHOLE

Senator HEINZ. With the exception of Mr. Patterson.

Now would you also support as part of that legislation language that would prohibit banks from invading financial services through what we have come to call the South Dakota loophole?

Mr. OLSEN. Well, as we look at the legislative package that's available, that would make the ground rules equal for all industries and we concur with that.

Senator HEINZ. Right; so if we got to the point where we decided, for whatever reasons, we could not pass the kind of comprehensive financial services bill everybody has been talking about and we did what you wanted, which is get rid of this big loophole for the invasion by nonbank interests into banking by casting off, as Dreyfus did with their so-called consumer bank, the commercial loan making, if we do that, you would also support our closing what I call the State-chartered bank loophole? Yes or no?

Mr. OLSEN. Well, I think there was a leapfrog in there that I wasn't prepared to accept, and that is skipping over the question of providing competitive equity in the marketplace. We are looking at the closing of that so-called South Dakota loophole as part of the total package.

Senator HEINZ. I'm saying if you can't get the total package, which is the financial services package, a lot of people here have said that if you can't give us real estate, securities, insurance, and so forth, close the nonbank bank loophole. Do you agree with that? Yes or no?

Mr. OLSEN. Well, we think it's too early to make that statement.

Senator HEINZ. It's not a statement. It's a question.

Mr. OLSEN. Then you're asking for an answer and——

Senator HEINZ. I'm not getting one, either.

Mr. OLSEN. I'm saying that it's too early to say what we would say at some point in the future. We are looking at it as a package and I can't answer for the association beyond that package.

Senator HEINZ. I'm not asking you to endorse the notion of no financial services legislation. I'm simply saying and asking what I think is a perfectly reasonable question, and I must say I'm puzzled, even disappointed, that you can't answer it because it is not a trick question. It is simply that if we decide to go and close—if we, not you—decide to go and close, as some of your people here have said, the nonbank bank loophole, if that's the way we are going to go, would you also support our closing the so-called South Dakota loophole at the same time? It's a question of balance. It doesn't put you on record as favoring that route. It's a question of if we're going down that route, how big is the truck going down the road? Does anybody want to answer that question?

Mr. PATTERSON. I'm just curious, if you take that route, what do you plan to do with the people that have already slipped through the loophole?

Senator HEINZ. Speaking for myself, I would hope that we would not go in for the kind of grandfathering that causes future problems.

Mr. KING. I would like to answer that question. The answer is yes.

Senator HEINZ. Thank you. I like your kind of answer. I didn't much care whether it was yes or no, I just wanted an answer.

Mr. HAMMER. Our answer is very strongly no, Senator. It's one way that banks have to serve customer banks and the fact that these have been successful indicates that there's a consumer need that's being served.

Senator HEINZ. You're saying that if we close the nonbank bank loophole and stop the invasion of Sears Roebuck or Dreyfus into banking, you want to still be able to invade them?

Mr. HAMMER. Yes; as a matter of fact, it's a big mistake to close the loopholes.

Senator HEINZ. OK. You've been clear. You've been honest. I can't quarrel with honesty. Does anybody else want to comment, Mr. Nicholson?

Mr. NICHOLSON. Senator, first off, I'd like the record to reflect that there may have been general nodding, but we have a difference of opinion relative to the definition of a bank.

Second, as to the South Dakota loophole, I would respectfully submit that the legislation in South Dakota is being repeated in a number of other States in this country this very day, not because the States have any particular interest to get into the banking legislation but, rather, because of the frustration of the banking industry. A number of bankers see it as their only way to expand their powers, their ability to compete, and to serve the American consumer.

Senator HEINZ. Well, you're anticipating my next question after the one I'm about to ask.

Mr. Pistor, do you have a comment on this?

Mr. PISTOR. Well, very quickly, I would just comment on an article which you probably noticed in the New York Times this past Sunday by Robert Bennett which dealt with this very subject. He quoted one of the association members, Mr. Petty, who I thought had a fairly colorful answer to the question, or at least it seems to me it is.

Senator HEINZ. I read the article. Maybe we ought to put it in the record.

[The article follows:]

[From the New York Times, Feb. 19, 1984]

THE BIG PUZZLE FOR BANKING: HOW TO MIX FREEDOM AND PROTECTION

(By Robert A. Bennett)

Not very long ago, banks were perceived as public utilities and their stocks were viewed as safe and sound investments. But that image has changed dramatically as banks, in recent years, have rushed helter-skelter into previously undreamed-of fields—and into a new banking era.

The primary goal of top managers in the nation's banks is no longer to keep their heads soberly above water and to lend only to those who are virtually risk-free. Today, as the banks leap into new markets and thrash about trying to maximize profits, they are begging people to borrow larger and larger amounts at interest rates that are freer than ever before to rise and fall. There are banks today selling insurance, stocks and even cut-rate merchandise. And the industry is banging on the doors of Congress and state legislatures for freedom to plunge even further into new businesses. There are nonbanks—brokerage firms, retailers and furniture stores—fighting for a bigger piece of the consumer banking market.

It's all happening in a national environment of dizzying deregulation that has transformed competition in trucking, airlines, communications—and banking. But in many minds, banking is fundamentally different from other industries that have been exposed to the cold winds of the marketplace. Deregulation of banking is potentially dangerous—not just for the institutions that might get caught up in turbulent markets for financial services, but for the nation.

The ultimate discipline of the marketplace in a deregulated world is the threat of bankruptcy. But big banks—which provide the financial underpinnings of the national economy—are too important to be allowed to collapse. Public policy has for decades affirmed this doctrine by keeping banks from going far afield into other businesses and by propping them up when they get in trouble.

Though the wave of deregulation is too new to have produced major gaffes yet by profit-driven banks, the changes have raised fears in some quarters about the future. "When you encourage the entrepreneurial drive of the banks," said Henry Kaufman, an economist and managing director of Salomon Brothers, "the only way that drive can be disciplined is by allowing banks that have behaved improperly to fail. This is a key issue. Are we willing as a society to have major institutions that hold savings and temporary funds fail so that the proper discipline can be exerted on them?"

Mr. Kaufman, whose firm is a direct competitor of the commercial banks in some areas, may have a biased view. But others in more neutral positions share some of his major concerns. Paul A. Volcker, chairman of the Federal Reserve Board, is perhaps the most prominent. He has been in the forefront of a call for a pause in the rush to deregulation so that the country can figure out what it wants its banking system to be. Both men are alarmed at the piecemeal fashion in which changes are being made in the financial system before an overall blueprint for change has been established.

Though little heed has so far been paid to Mr. Volcker's call, a major public policy debate about the future of banking has begun bubbling to the surface in Washington, in academia and on Wall Street. A few diehard free-marketeers argue that the virtues of marketplace efficiency so clearly overwhelm the risks from bank failure that deregulation should go all the way to freedom for the banks—including the freedom to fail.

But the major debate emerging is between those like Mr. Volcker and Mr. Kaufman who think that the process of bank deregulation should proceed in a more orderly fashion so that the emerging financial structure can be carefully designed to meet the nation's basic needs, and others, like Walter B. Wriston of Citicorp and William M. Isaac of the Federal Deposit Insurance Corporation, who want to sweep away the remaining cobwebs of regulation quickly to open the banks and nonbanks to even grander competition.

According to Mr. Wriston, banking regulations have traditionally lagged behind reality. Explaining his passion for breaking down old restraints on bank operations, he once said, "My experience has been you either move forward or you die—it's true in all biology."

Mr. Wriston was a pioneer, but now most bankers seem to agree with him about the need to push aggressively for new powers. "Bankers want to be protected but yet they want a lot of freedom," said George M. Salem, a bank-stock analyst at A.G. Becker Paribas Inc.

For decades, banks have operated under a tacit quid pro quo with the United States Government. They have agreed to certain limits on their operations in return for certain privileges, protections and the Government's ultimate backing of their liabilities. Banks are lenders of last resort to American industry—and the Federal Reserve Board is the lender of last resort to them. Banks are the vehicles through which the central bank channels monetary policy. It is through the banks that the Government often deals with major economic crises, ranging from the quadrupling of oil prices in 1973 to the 1980 silver debacle that threatened to topple major securities firms.

In quiet and subtle ways, the Government also often works through the major banks to implement aspects of foreign policy. Some years ago, for example, when the State Department wanted to help the Polish Government, Washington quietly had the Commodity Credit Corporation guarantee commercial bank loans to Poland. And in the last year or so, when the big banks ran into trouble as a result of the heavy lending to third world countries—which had been encouraged by the Government—the Government once again rushed to their aid. The Treasury, through its Exchange Stabilization Fund, loaned billions of dollars to such countries as Mexico and Brazil to keep them afloat, and the regulators in Washington even bent some rules so that the private banks could participate in complicated programs to reschedule these countries' huge debts.

The unique position of the banking system in the United States is mirrored abroad. Few nations, even the most liberal on matters of foreign investment, would allow their largest banks to be taken over by foreigners. And many major nations, such as France and Italy, have nationalized their banking systems.

In large part, the special position of banks stems from the awesome power they have in controlling vast amounts of capital. For that reason, most democracies, including the United States, have taken pains to assure that those powers are not abused, and that banks do not show favoritism to one potential borrower over another. That is a major reason that United States laws have prohibited banks from engaging in most other businesses.

Today, however, with the deregulation craze in full swing, many of the truisms of the past are being ignored. As a result of dramatic technological advances that have made it practical to provide banking services through toll-free phone calls, the mails and automated teller machines, many nonbanks have begun to enter banking. And, in some cases, because they are not fettered by costly, high-overhead branch structures, they can beat the banks at their own game.

At the same time, banks are going ahead willy-nilly, finding loopholes in state and Federal laws that allow them to enter new, and sometimes riskier, activities.

Only last week, the Bank of America, the nation's largest bank, announced that it would begin offering insurance in its California branches, although currently it is illegal for banks to engage in most types of insurance activities. The bank's strategy: placing another company's agents in the banks branches to sell the insurance.

New York-based Citicorp, the country's biggest bank holding company, which has been gobbling up savings and loans around the country, is operating a convention center in Westchester County and offering customers a discount shopping service. Chemical Bank, another New York-based financial giant, has published a catalog offering cut-rate merchandise to its customers. And banks across the country have begun selling stocks, a practice that until recently was considered a violation of the 1933 Glass-Steagall Act, which suddenly is being interpreted differently.

As the banks extend their reach into new markets, their new competitors are looking over the fence, too, in the other direction, combing the law books for new ways to make profits from consumer banking services. Indeed, Sears, Roebuck & Company, the nation's biggest retailer, today earns roughly as much money from financial services as from selling merchandise, and its top management is on the prowl for 51 more banks to add to its sole savings and loan in California.

Not only Sears, but many businesses that once were quite distinct from banks have begun to look remarkably like them. Money market mutual funds, most of which are operated by securities firms, take deposits and even allow their customers to write checks. Even supermarkets and gas stations are installing automatic teller machines.

While all this has transpired, the attention of policy makers in Washington and in state capitals has been focused for the most part on narrow questions: Should banks be allowed to cross state lines? Should they be allowed to underwrite corporate securities? Should they be allowed into insurance? Should deposits in money market mutual funds, the banks' arch rivals, be insured by the Federal Government? Should securities firms, insurance companies and others be allowed to buy banks?

What's required now, said Charles M. Williams, George Gund Professor of Banking at Harvard Business School, is a "more focused discussion of what kind of banking system we need. It strikes me that, to answer the question of what powers a bank should have, there is a plaintive cry to determine just what banking is."

One thing seems clear: If policymakers continue to believe the nation's major banks and their depositors should be protected by such Government-supported institutions as the FDIC and the Federal Reserve, there must be some form of regulation in effect to temper the banks' activities. William R. Cline, a senior fellow at the Institute for International Economics in Washington, explained: "The counterpart of Government insurance is some degree of Government regulation because, if the Government merely provides safeguards, it would tend to create excessive risk-taking by the banks. The central question is where one strikes the proper balance between differing levels of regulation."

In trying to explain the role of the banking system, Mr. Volcker recently told a Congressional committee that "our point of departure is the basic proposition that banks, and depository institutions generally, continue to perform a unique and critical role in the financial system and the economy—as operators of the payments system, as custodians of the bulk of liquid savings, as key and impartial suppliers of short-term credit, and as the link between monetary policy and the economy.

"This unique role," he said, "implies continuing governmental concerns about the stability and impartiality of these institutions—concerns that are reflected in the Federal 'safety net' long provided by the discount window and by deposit insurance, by regulatory protection against undue risk, and by policies to discourage conflicts of interest and undue concentration of banking resources."

On the broad issues, Mr. Volcker's arguments elicited some sympathy at recent hearings from Jake Garn, the Utah Republican who heads the Senate Banking Committee. And Mr. Volcker said that he agrees with many elements of a bill Mr. Garn has submitted that would substantially expand the powers of the banks.

But there also have been important areas of disagreement. Last year, for example, Mr. Garn responded negatively when Mr. Volcker sought legislation to close, temporarily at least, a loophole that allowed nonbanking companies to acquire banks and run them as strictly consumer-banking organizations. Even other Federal regulators reacted cooly to Mr. Volcker's pleas, although eventually they agreed to a moratorium. But that came late in the game and did not apply to applications for such "nonbank banks" that already had been received by regulators. In fact, only last Friday the Comptroller of the Currency approved a pending application for such a bank that had been submitted by the FMR Corporation, which operates the Fidelity Group of mutual funds. Unlike money market funds that take consumers' money and issue checks, these new nonbank banks are insured by the FDIC. Others that have received such consumer bank licenses include the American Express Company, the J.C. Penney, the Dreyfus Corporation, the Beneficial Company, the Parker Pen Company and Western Family Inc., a chain of furniture stores in the West.

In the emerging debate over the future of American banking, Alan Meltzer, a monetarist economist at the Carnegie-Mellon Institute in Pittsburgh, stands to one side. He says banks should be fully subject to market pressures and even the biggest should be allowed to fail.

"You can't have deregulation without people accepting the risk," he said. "There has to be an understanding that if banks get into trouble, they have to pay the consequences. You can't have a system where the banks are free to take as much risk as they choose and then dump the losses on the taxpayer."

The role of the Federal Reserve, according to Mr. Meltzer, should be to avoid a chain reaction if a major bank were to fail. If such a failure were to cause a run on banks, the Fed should lend money to banks that run short of cash, but such loans should be made at penalty rates and should be backed with top-quality collateral, he said.

Within the high reaches of Government, Mr. Isaac of the FDIC comes closest to agreeing with Mr. Meltzer's free-market philosophy.

"During much of the last 50 years we have relied excessively on Government and not enough on market forces," Mr. Isaac said last week. "That has been done at great cost."

And Mr. Isaac advocates some fairly radical moves to impose "market discipline" on the banking system. Currently, all banks insured by the FDIC pay the same rates on their insurance premiums. But Mr. Isaac would vary the premium according to the agency's estimate of the riskiness of a particular bank's activities.

He also advocates asking big depositors to "share the risk" with the FDIC. The agency has often in recent years merged a failing bank or savings bank into a stronger one as a way of avoiding outright bankruptcy. This tactic usually is possible only if the FDIC agrees to make up any losses passed along to the new institution. Under Mr. Isaac's scheme, big depositors—those with more than $100,000 in the problem bank--would be required to share some of the loss with the FDIC.

But even Mr. Isaacs argues that the Government must play a role in banking. "There's always going to be a fair amount of Government involvement in banking compared with any other businesses because banking is so central to the working of the economy," Mr. Isaac said. "We've had periods when banking was relatively free of regulation. Those periods were characterized by one crisis after another. It's not realistic to think that Government will ignore banking; what we're talking about is balance." In much of the 19th century, when banking regulation was virtually nonexistent, financial panics and bank failures were commonplace.

Mr. Kaufman of Salomon Brothers, thinks the Isaac strategy would sweep away too much regulation. He contends that banks and Government are inseparable and that it's dangerous to give banks too much leeway. "You are dealing with one of the most powerful ingredients within a society," Mr. Kaufman said last week.

For their part, most bankers say they have little choice but to move into new fields. They claim that they have lost much of their traditional business in nonbanking companies.

It began, they say, in the 1960's, when big corporations started lending directly to one another through the so-called commercial paper market. This reduced the major source of the big banks' deposit and loan business. And still more business was lost as the result of the development of the "Eurodollar" market in London, where corporations could shop for cheap loans and high deposit rates from banks around the world.

These pressures on their corporate business caused many large banks to increase their dealings with consumers. But there too, banks have run into stiff competition from nonbanks. In fact, until banks were allowed to pay market-oriented interest rates at the end of 1982, the unregulated money market mutual funds had drawn almost $200 billion in deposits from the banking system. But the change also raised the cost of funds to the banks, and this has caused many to stretch further for profits.

According to many economists, the far higher rates banks must now pay for consumer deposits has contributed importantly to the higher interest-rate levels that now prevail nationwide.

Some bankers are deeply unhappy about the changes. "I accept that concept of a special role, of the uniqueness of a deposit-taking privilege," said John R. Petty, chairman of the Marine Midland Bank and former Assistant Secretary of the Treasury in the Johnson and Nixon Administrations. "But something happened on the way to the farm. Some years back that uniqueness disappeared. Had the regulators and Government been resolute in preserving it, the whole view of the banks in the community and deregulation would have taken a different course."

"I find it inconceivable that anybody could walk the cat back," lamented Mr. Petty.

DEREGULATING AWAY THE LITTLE GUY

For Edward O., who recently got a job as an elevator operator on Manhattan's Upper West Side, deregulation of the banks has not been so great.

After being unemployed for a while, he was thrilled to get a steady job, and as soon as he got his first paycheck he rushed to open a savings account at a bank.

But to his surprise, Edward found that he and his money were not particularly welcome. By the banks' reckoning, his opening deposit of $100 would have been too small for them to make a profit.

While most did not reject the account, they refused to pay interest on it, and several asked for monthy service fees for keeping his savings.

Like many lower-income people, Edward was a victim of deregulation. In the old days, when Federal regulations prevented banks from paying high rates on savings, high-balance depositors in effect subsidized those, like Edward, with low-balance accounts.

No more. Even while the Government continues to maintain a safety net under the banks themselves, the poor and those with only moderate incomes are expected to pay their own way.

"Obviously, making a profit has got to be foremost among the banks' priorities because if they don't make profits they won't survive," said William M. Isaac, chairman of the Federal Deposit Insurance Corporation. "In a truly competitive market, if the banks price people out of the market, it will make room for others."

Howard M. Stein, chairman of the Dreyfus Corporation, contends that he could be one of those others. The chief business of Dreyfus is operating mutual funds, but Dreyfus is one among a handful of non-banks that, through a loophole, have acquired a commercial bank. Mr. Stein found that he could buy a bank, sell off its commercial-loan portfolio, and avoid coming under the provisions of the law that bars nonbanks from buying banks.

According to Mr. Stein, the Dreyfus Consumer Bank, unfettered by a costly branch network, has been offering higher rates than most banks on savings accounts and has drastically cut fees and interest rates on consumer services.

Things could be even better for the consumer, says Mr. Stein, if the Federal Reserve would leave his bank alone. Unhappy about the intrusion of nonbanks into banking, the Fed has blocked the Dreyfus bank and others like it from investing in corporate i.o.u.'s and from issuing certificates of deposit. Mr. Stein says that if these restraints were lifted, even more benefits would be passed on to his customers.

"The consumer's going to have to get a better break," he said, "and we can give them an alternative."

But even with Dreyfus, an individual can be too poor. To open an account at the Dreyfus bank, which is based in East Orange, N.J., or at one of Dreyfus's mutual funds, you need at least $2,500.

Mr. PISTOR. You really can't walk the cat backward, and the fact is that it seems to me to be very difficult to assume that we should at this point not be progressing.

Senator HEINZ. That's really my second question. You commented on the notion of share market of banks.

Mr. PISTOR. Yes.

Senator HEINZ. What measure of share are you using when you talk about share?

Mr. PISTOR. I think the way we talk about it, in our general terms, is it's just total financial assets across the board. I think if you were to look and examine——

Senator HEINZ. Deposits, and loans, and securities held by banks as a proportion of these assets held by everybody else?

Mr. PISTOR. That's sort of the M1. That's the basic measure. I think our share of market would be broader than that. We would be talking about share of market, the market being defined as assets and deposits throughout all the financial institutions, thrifts, commercial credit concerns, the Merrill Lynches, and so forth.

BANK'S SHARE OF THE MARKET HAS CHANGED IN LAST 10 YEARS

Senator HEINZ. Now securities and loans are carried on your books as an asset. A deposit is carried on your books as a liability. What statistics do you have that show how you're doing with respect to your share of market as regards to loans and securities? Has it changed over the last 10 years?

Mr. PISTOR. Yes.

Senator HEINZ. What is it today? What is the share of market today?

Mr. PISTOR. I don't have any figures.

Senator HEINZ. Mr. Olsen, representing the ABA, probably is the best person to answer that.

Mr. OLSEN. I don't have those precise figures. We could certainly get them and submit them for the record.

Senator HEINZ. Let me suggest that I think those figures are really material. All of you have argued in effect: "Listen, our businesses are being jeopardized by a lot of innovation in financial services." The proof of that statement has to be, among other things, whether these new instruments are, in fact, making market inroads which should be reflected ultimately in share of market. One of the reasons we passed Garn-St Germain—one of the reasons that so many of us insisted that there be a so-called competitive instrument, the money market deposit account, in that legislation is that we felt banks had to have a mechanism to compete for deposits, if you will, on the liability side; and I happen to feel we didn't go far enough because you're subject, both on super-NOW's and on MMDA's to reserve requirements which is money that lies fallow in the vault, somebody else's vault at that, and if we really want to make you competitive, if we want to fulfill what I think was the valid intent of Congress, we should give you the reserves on those deposits. It was unfortunate we weren't in a position to do that at that time, although it's something I and others have been for on this committee. It's something we need to do. The Federal Reserve is now in favor of it.

And the key question, it seems to me, is, once we get that done right—and it isn't done right yet—it's a big improvement, but not done right—are you really going to be losing share of market even with the money market deposit account, and you were tremendously successful in recapturing a lot of money you lost to the money market funds. Have you got any comments on share of market as to factually how it is trending?

Mr. OLSEN. Well, Senator, I would like to speak to your last example of the money market funds. As you are well aware, when the banks did not have the ability to offer a competitive product, a market was created outside of our industry that exceeded $200 billion. On December 14, 1982, banks were given a competitive instrument, the money market deposit account [MMDA]. The MMDA has proven to be very popular with our customers. However, depository institutions have not recovered all the funds which fled to money-market funds prior to deregulation. In fact, noninstitutional money funds still have almost $140 billion in assets.

I think the lesson there is that when we are not able to participate in a market, once that market gets away from us, we don't recover it to any great extent. A lot of what happened——

Senator HEINZ. I hear what you're saying, but I'd like to wrap it up in numbers, and I asked you for numbers and, unfortunately, because my time is brief indeed, because I haven't got any information out of you in the last two questions, I find myself a little frustrated. My time has expired, even though I'd like to follow that up, Mr. Chairman.

The CHAIRMAN. Mr. Olsen, could you supply answers to Senator Heinz' question for the record specifically—obviously you don't have those numbers with you.

[The following information was subsequently supplied for the record:]

RESPONSE TO SENATOR HEINZ'S QUESTIONS FOR THE RECORD FROM MARK OLSEN, CHAIRMAN, GOVERNMENT RELATIONS COUNCIL, AMERICAN BANKERS ASSOCIATION

BANKING'S MARKET SHARE

1952 - 1983

Prepared by the
Economic and Policy Research Division
American Bankers Association
March 1984

Controversy has developed over the behavior of banking's share of the financial services market. The conventional wisdom is that bank market share has declined. However, one recent study concluded that banks have not lost market share.[1] The following paper reviews the evidence and concludes that banks have, indeed, lost market share. Our discussion also indicates how the complexity of the issue may have led different analysts to reach different conclusions from the same evidence.

The best data to analyze bank market share are found in the Flow of Funds Accounts produced by the Federal Reserve. Using these data, one can construct several broad measures of the commercial bank share of financial intermediation. While measures of market share based on Flow of Funds data are far from perfect, they are subject to fewer problems than other measures of market share.

The Flow of Funds data show that there has been a significant decline in bank share of lending markets. The commercial bank share of total financial assets held by all financial institutions declined from 49.7 percent to 35.5 percent between 1952 and 1982 (see Figure 1). The bank share declined significantly during the first half of the period, mostly because the demand for mortgage credit led to the rapid growth of savings and loans at a time when many banks were restricted in their ability to provide real estate credit. To help stem the decline, banks changed their product and service mix (most importantly by offering large certificates of deposit beginning in the early 1960's).

Bank share of total assets held by financial institutions declined again between 1974 and 1982. Part of the decline in the banking industry's share of total financial assets between year-end 1978 and year-end 1982 can be traced to the rapid growth of money market mutual funds ($10.8 billion to $206.6 billion). This illustrates what happens when banks are prevented by regulations from competing in financial markets. However, the most recent decline in bank market share began in 1975 and predates the most rapid growth in money market funds suggesting other factors may be at work. While the decline in bank share of total financial assets since 1974 is less rapid than the decline in bank share during the 1950's, its persistence raises serious questions about the competitive future of the banking industry under current regulations.

Depository institutions were allowed to offer a short-term instrument paying market interest rates with the introduction of the Money Market Deposit Account in December 1982. This eliminated one of the competitive disparities between banks and the money market funds. Flow of Funds data for year-end 1983 are not yet available. Nevertheless, data for June 1983 indicate that banks continued to lose market share suggesting that there are other regulatory constraints that continue to place banks at a competitive disadvantage with respect to other institutions. A part of this decline during 1983 may have been due to the resurgence of activity in equity markets in which banks are prevented from participating. However, care should be taken in interpreting June 1983 data because of the difficulties of seasonal adjustment.

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[1] See the Appendix to the Annual Report of the Federal Reserve Bank of Minneapolis, 1982.

Figure 2 shows the shares of credit market claims against nonfinancial sectors held by various types of private financial institutions. This measure excludes certain assets such as deposits and equity holdings that are included in Figure 1. It also nets out claims on other financial institutions. Hence, it represents total lending by financial institutions to the non-financial sector. The bank share shows a pattern similar to that shown in Figure 1.

Figures 3 and 4 show two other measures of market share based on Flow of Funds data. Figure 3 shows credit market debt claims against non-financial sectors held by all sectors including the non-financial sectors. Figure 4 is similar but includes credit market claims against financial as well as non-financial sectors. Figure 3 and Figure 4 show a much smaller decline in bank market share during the 1950's that was offset in the late 1960's and early 1970's. The difference in the pattern during the 1950's shown in Figures 1 and 2 and the pattern shown in Figures 3 and 4 results from the fact that a rising percentage of total lending during this period was going through financial intermediaries. However, Figures 1 and 2 clearly show that banks were losing market share to other financial intermediaries during this period. In Figures 3 and 4 this decline is partially offset by the rising share of lending that passed through financial intermediaries during this period.

More importantly, each of the measures shown in Figures 1 through 4 show a persistent decline in bank share since 1974. Each of these measures has its own strengths and weaknesses for purposes of measuring market share. In spite of these differences, each of these measures shows a decline in bank share since 1974.

Care should be taken in interpreting these ratios. The Flow of Funds data are subject to certain limitations in measuring market share. One of these limitations is that the Flow of Funds data capture only those financial activities that affect the balance sheet. For example, the activities of securities brokers and underwriters do not get attributed to that sector since they usually do not affect their balance sheet.

In addition, the banking sector in the Flow of Funds accounts does not include nonbank subsidiaries of bank holding companies. Data on the assets of nonbank subsidiaries are not available. However, fragmentary data from several different sources suggest that assets of nonbank subsidiaries did not exceed 4-5 percent of bank assets in 1982, the level estimated in a 1978 Federal Reserve study.[2] Hence, it does not appear that the assets of nonbank subsidiaries have grown rapidly enough since 1978 to offset the decline in bank market share.

While the Flow of Funds data do have shortcomings, they still are the broadest and probably the most reliable indicator of market share available.

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[2] Details of the estimate of this ratio for 1982 are available from the Economic and Policy Research Division of the ABA.

Minneapolis Federal Reserve Study

The recent study of bank market share by the Federal Reserve Bank of Minneapolis examined data from the Flow of Funds Accounts, the National Income and Product Accounts, and several other sources. The study concluded that banks had not lost market share. For several reasons, we believe this conclusion is not supported by the evidence. First, in examining the Flow of Funds data, the Minneapolis Fed study uses five-year moving averages in order to smooth out short-run fluctuations. However, as Tables 1 and 2 show, there is little erratic year-to-year movement in the Flow of Funds market shares. The use of five-year moving averages tends to obscure the decline in bank market share since 1974.

Second, the Minneapolis Federal Reserve study appears to discount the recent decline in the bank share of total assets of financial institutions because the Flow of Funds do not include the foreign assets of commercial banks. However, our concern is the declining bank market share of domestic intermediation and, thus, it is correct to exclude foreign assets when constructing measures of market share.

The Minneapolis Federal Reserve study goes on to examine several measures of market share based on data from the Finance, insurance, and real estate sector in the National Income and Product Accounts. Four different measures of size were examined: employment, total compensation, after-tax profits, and national income. Employment, compensation, and profits all measure the value of or the returns to one of the inputs in the production process, in this case the production of financial services. In theory, National Income measures the returns to all inputs used in the sector. Thus, all four measures can all be considered an indicator of size. However, each of these measures has a critical defect for measuring bank market share.

Employment, compensation, and profits measure only one of several inputs used in the production process. Whenever there is a change in the relative amounts of these various factors used in the production process, these measures are unreliable indicators of the total size of the industry. Such a substitution has occurred in the banking industry. Beginning in the mid-1960's, the high level of market interest rates relative to regulatory deposit interest rate ceilings forced banks and thrift institutions to compete for funds on the basis of service and convenience rather than on the basis of interest rates. To provide this increased service and to staff the branches opened to provide greater convenience, banks hired more employees. Thus, although the bank share of financial assets declined, their share of financial sector employment and total compensation did not.

Profits suffer the same defect in measuring bank market share; they measure the return to only one factor input, in this case, capital. Moreover, a comparison of industry size based on profits is clouded by severe accounting problems.

The Minneapolis Fed study also looks at bank share of National Income in the Finance, insurance, and, real estate sector. In theory, National Income measures the return to factors used in the production process and should provide an indication of the size of various components of the

Finance, insurance, and real estate sector. However, this measure is, perhaps, the most defective of all the measures from the National Income and Product Accounts. In the financial sector, the three largest components of National Income are compensation of employees, profits, and net interest. The net interest component of National Income is defined as interest expense minus interest income. The net interest of most financial intermediaries is negative since interest income exceeds interest expense. Thus, a decline in the bank share of total assets of financial institutions could actually tend to increase the bank share of the National Income of the entire Finance, insurance, and real estate sector.

For all of these reasons, we believe that the National Income and Product Account measures are very unreliable indicators of changes in market share. The Minneapolis Fed study goes on to look at various measures of profitability and stock market performance. While this is perhaps interesting for some purposes, it is not clear what relationship these measures have to market share.

Conclusion

Interpretation of changes in bank market share data over time is difficult, at best. All of the measures have shortcomings and different measures sometimes behave differently. Nevertheless, a review of the data suggests the following conclusions.

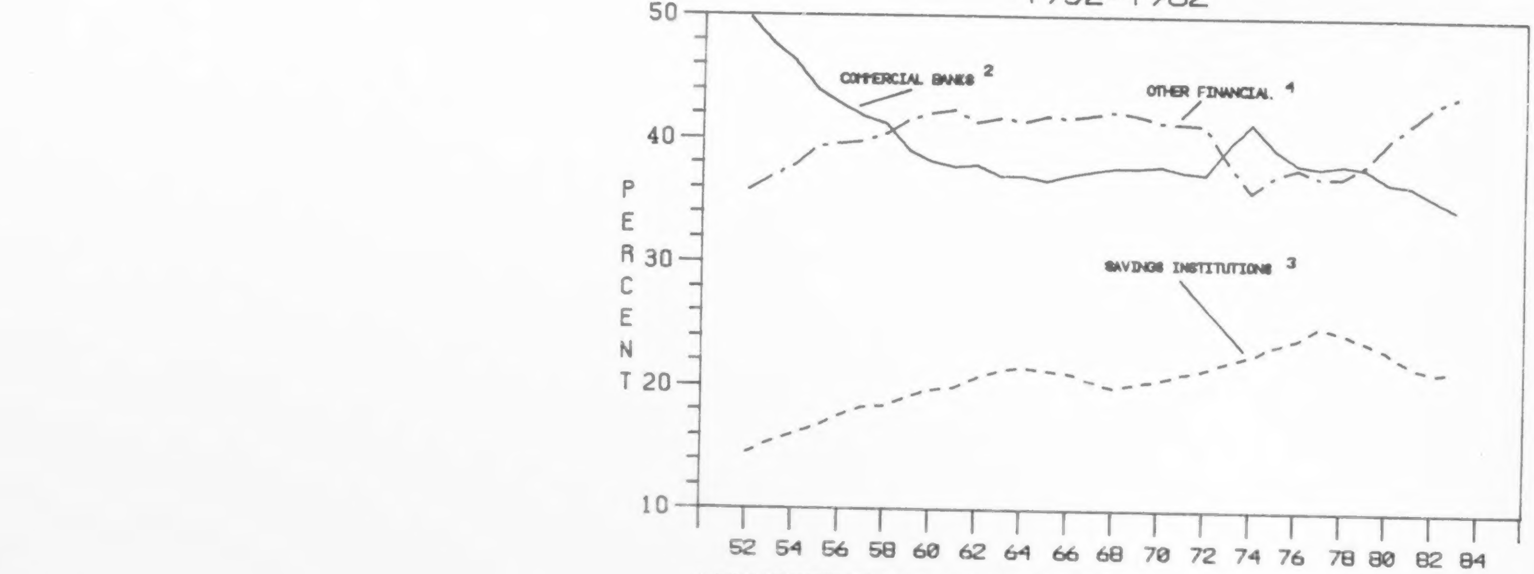
1. The Flow of Funds data which are probably the best overall measure of market share suggest that bank market share declined significantly in the 1950's. A small portion of this loss was recovered in the late 1960's and early 1970's.
2. More importantly, there has been a decline in bank market share since 1974 at least partly as a result of the growth of the money market mutual funds. This decline demonstrates what happens when regulations prevent banks from competing against other financial institutions.

Finally, a word should be added about the relevance of this market share data to the products and services issue. The elimination of deposit interest rate ceilings should stop the decline in market share that has resulted from the inability of banks to pay competitive interest rates. However, there are a growing number of institutions that can provide financial services to their customers at greater convenience and, perhaps at lower cost because of their ability to offer a wide range of financial services. If regulation continues to prevent banks from competing, they are likely to continue to lose market share.

FIGURE 1

SHARES OF TOTAL FINANCIAL ASSETS HELD BY FINANCIAL INSTITUTIONS[1]

1952-1982



[1] INCLUDES CREDIT MARKET DEBT CLAIMS AGAINST NONFINANCIAL SECTORS, PLUS CURRENCY, DEMAND AND TIME DEPOSITS, SECURITY CREDIT, CORPORATE EQUITIES, MEMBER BANK RESERVES, AND MISCELLANEOUS ASSETS

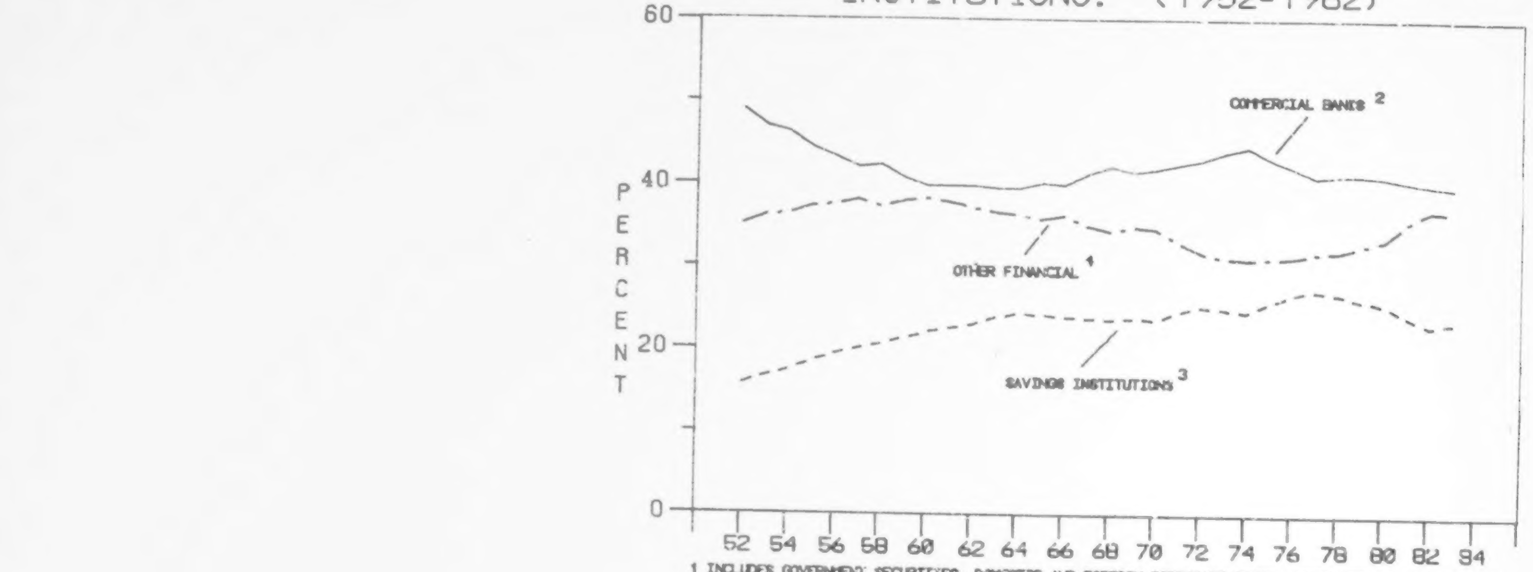
[2] CONSISTS OF U.S. CHARTERED BANKS, DOMESTIC BANK AFFILIATES, EDGE ACT CORPORATIONS, AGENCIES AND BRANCHES OF FOREIGN BANKS, AND BANKS IN U.S. POSSESSIONS. DOES NOT INCLUDE NON AFFILIATES OF BANK HOLDING COMPANIES OR FOREIGN AFFILIATES OF U.S. CHARTERED BANKS.

[3] CONSISTS OF SAVINGS AND LOAN ASSOCIATIONS, SAVINGS BANKS, AND CREDIT UNIONS

[4] CONSISTS OF INSURANCE COMPANIES, PENSION FUNDS, FINANCE COMPANIES, REAL ESTATE INVESTMENT TRUSTS OPEN-END INVESTMENT COMPANIES, MONEY MARKET FUNDS, AND SECURITY BROKERS AND DEALERS.

FIGURE 2

SHARES OF TOTAL CREDIT MARKET DEBT CLAIMS AGAINST NONFINANCIAL SECTORS HELD BY PRIVATE FINANCIAL INSTITUTIONS. (1952-1982)



1 INCLUDES GOVERNMENT SECURITIES, DOMESTIC AND FOREIGN CORPORATE BONDS, MORTGAGES, CONSUMER CREDIT DOMESTIC AND FOREIGN OPEN MARKET PAPER, OTHER DOMESTIC AND FOREIGN BANK LOANS, AND OTHER DOMESTIC AND FOREIGN DEBT INSTRUMENTS.

2 CONSISTS OF U.S. CHARTERED BANKS, DOMESTIC BANK AFFILIATES, EDGE ACT CORPORATIONS, DOMESTIC AGENCIES AND BRANCHES OF FOREIGN BANKS, AND BANKS IN U.S. POSSESSIONS. DOES NOT INCLUDE NONBANK AFFILIATES OF BANK HOLDING COMPANIES OR FOREIGN AFFILIATES OF U.S. CHARTERED BANKS.

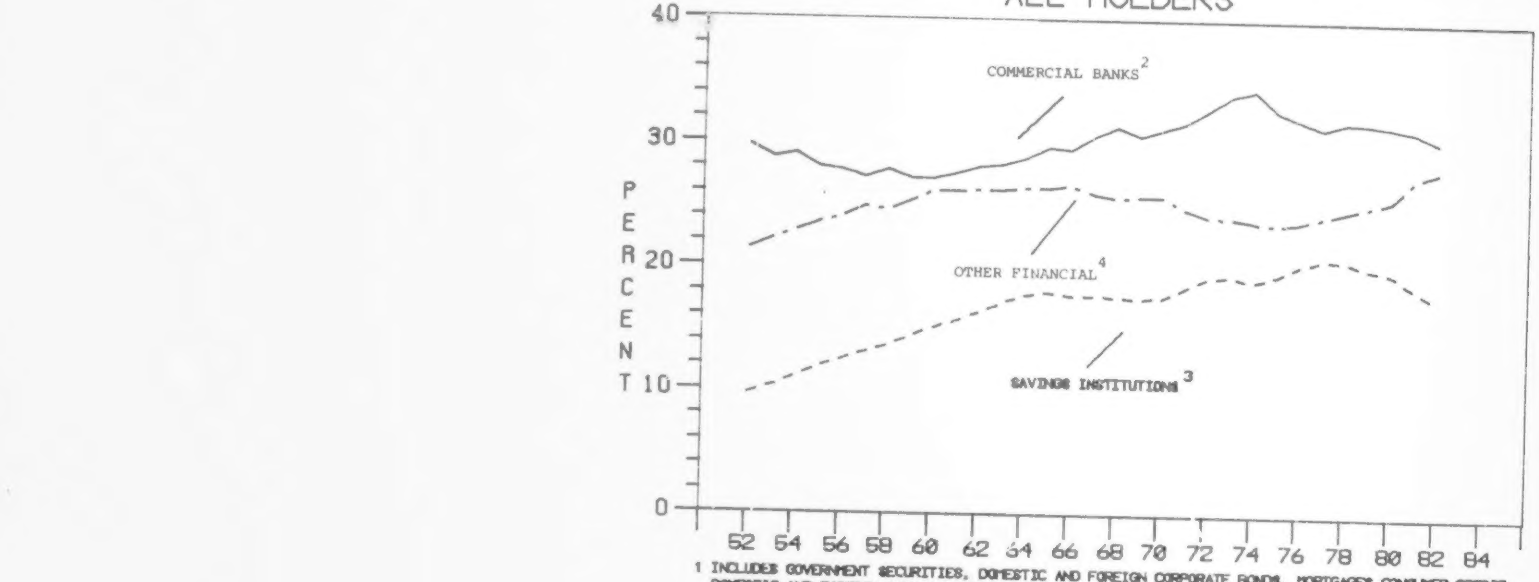
3 CONSISTS OF SAVINGS AND LOAN ASSOCIATIONS, SAVINGS BANKS, AND CREDIT UNIONS.

4 CONSISTS OF INSURANCE COMPANIES, PENSION FUNDS, FINANCE COMPANIES, REAL ESTATE INVESTMENT TRUSTS, OPEN-END INVESTMENT COMPANIES, MONEY MARKET FUNDS, AND SECURITY BROKERS AND DEALERS.

SOURCE: BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM. FLOW OF FUNDS ACCOUNTS, ASSETS AND LIABILITIES OUTSTANDING.

FIGURE 3

SHARES OF TOTAL CREDIT MARKET DEBT CLAIMS AGAINST NON-FINANCIAL INSTITUTIONS BY ALL HOLDERS



[1] INCLUDES GOVERNMENT SECURITIES, DOMESTIC AND FOREIGN CORPORATE BONDS, MORTGAGES, CONSUMER CREDIT DOMESTIC AND FOREIGN OPEN MARKET PAPER, OTHER DOMESTIC AND FOREIGN BANK LOANS, AND OTHER DOMESTIC AND FOREIGN DEBT INSTRUMENTS.

[2] CONSISTS OF U.S. CHARTERED BANKS, DOMESTIC BANK AFFILIATES, EDGE ACT CORPORATIONS, DOMESTIC AGENCIES AND BRANCHES OF FOREIGN BANKS, AND BANKS IN U.S. POSSESSIONS. DOES NOT INCLUDE NONBANK AFFILIATES OF BANK HOLDING COMPANIES OR FOREIGN AFFILIATES OF U.S. CHARTERED BANKS.

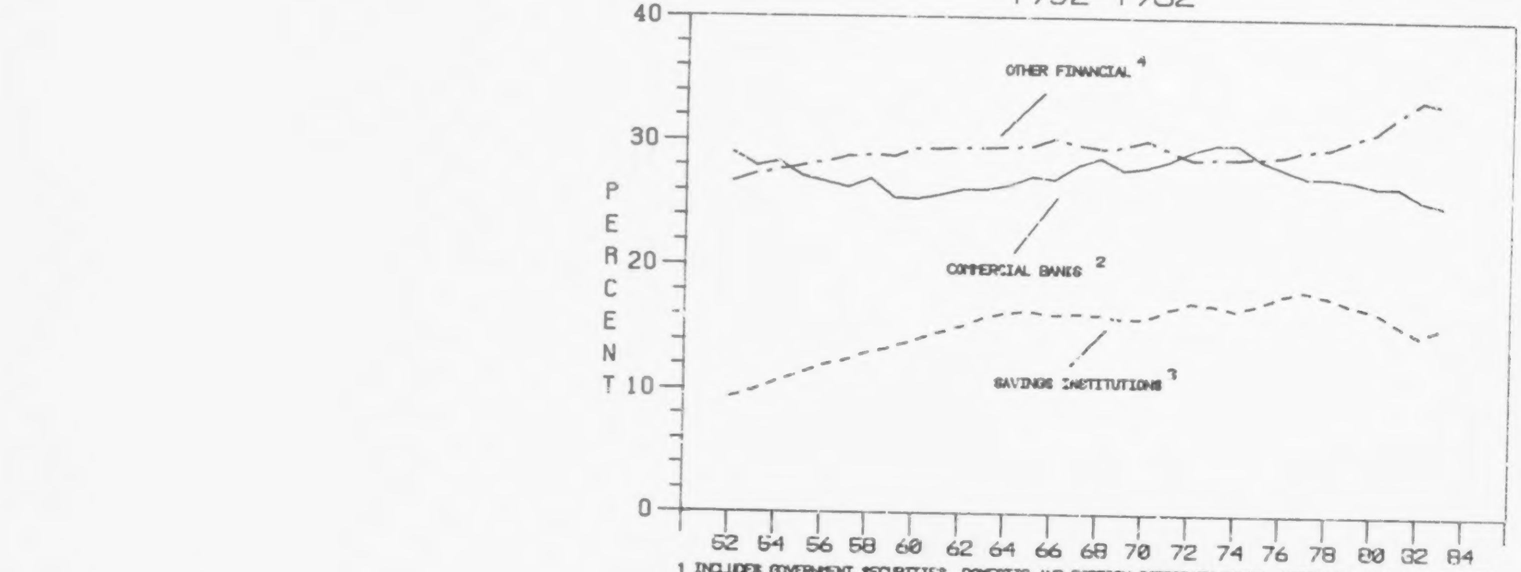
[3] CONSISTS OF SAVINGS AND LOAN ASSOCIATIONS, SAVINGS BANKS, AND CREDIT UNIONS.

[4] CONSISTS OF INSURANCE COMPANIES, PENSION FUNDS, FINANCE COMPANIES, REAL ESTATE INVESTMENT TRUSTS, OPEN-END INVESTMENT COMPANIES, MONEY MARKET FUNDS, AND SECURITY BROKERS AND DEALERS.

SOURCE: BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM. FLOW OF FUNDS ACCOUNTS, ASSETS AND LIABILITIES OUTSTANDING.

FIGURE 4

SHARES OF TOTAL CREDIT MARKET DEBT CLAIMS AGAINST ALL SECTORS BY ALL HOLDERS[1]
1952-1982



1 INCLUDES GOVERNMENT SECURITIES, DOMESTIC AND FOREIGN CORPORATE BONDS, MORTGAGES, CONSUMER CREDIT DOMESTIC AND FOREIGN OPEN MARKET PAPER, OTHER DOMESTIC AND FOREIGN BANK LOANS, AND OTHER DOMESTIC AND FOREIGN DEBT INSTRUMENTS.

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SOURCE: BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM. FLOW OF FUNDS ACCOUNTS, ASSETS AND LIABILITIES OUTSTANDING.

Senator **Heinz**. Mr. Chairman, could I ask just one question? What is either the total assets or the total liabilities and equity of banks in the United States? We throw around $35 billion in mortgage revenue bonds that you can't compete for, $200 billion in the money market funds. How much are you talking about? What is, to the nearest trillion dollars——

Mr. **Olsen**. $2 trillion.

Senator **Heinz**. $2 trillion is the asset or the liability side?

Mr. **Olsen**. Well, it's the nearest——

Senator **Heinz**. Is that deposits or is that loans and securities?

Mr. **Olsen**. Total assets.

Senator **Heinz**. Total loans and securities, $2 trillion. Thank you. That's very helpful.

Mr. **Nicholson**. Senator, if I may, commercial banks, savings and loan associations, mutual savings banks, credit unions, agencies and branches of foreign banks, and Edge Act corporations, in September 1983, held $2,338 million of deposits.

Senator **Heinz**. Thank you very much.

Mr. Chairman, thank you.

The **Chairman**. Mr. King, you expressed not only opposition to interstate banking changes and changes in McFadden and Douglas, but you expressed opposition to interstate banking compacts.

Now in my bill there is nothing about McFadden or interstate banking and nothing about regulation because, as many of you have testified, I think you have to do things in the proper sequence. Until you decide who's going to do what, you can't decide geographical boundaries or you can't decide who's going to regulate.

STATES MAY ACT IF CONGRESS IS NOT WILLING TO DO SO

I agree with you that that needs to come in a sequence, but even though you do oppose interstate banking, I wonder why you believe States should not be permitted to act if Congress, for whatever reason, is not willing to act? I represent a small State. You come from a small State. I feel very strongly, whether I agree with the State legislature or not—and I often don't agree with my own—but I certainly will defend their right to thumb their nose at the Federal Government and do anything they want to within the boundaries of their States.

I guess I'm getting into a State's rights issue now and we're not in disagreement on the issue of timing of interstate banking. However, if six union States want to get together and their legislatures act independently, why not?

Mr. **King**. Well, here again, we're talking about concentration of assets and concentration of power. The position of IBAA is that we are opposed to concentration. In these instances, we're going outside of the actual States for those types of decisions. In other words, those State agreements go back and forth, but they involve one State with another State with their business decisions.

We would prefer to stand on our position that we are opposed to the concentration of those assets.

The **Chairman**. I don't disagree with you there either. I'm opposed to concentrations, wherever they occur, whether it's in big financial banking institutions, or big insurance companies, or big securities dealers, and as outlined by one of the gentlemen, the concentrations are greater in some of the so-called nonbank banks than within the banking industry. But I'm getting to an issue of State's rights here, not a matter that I've stated very clearly.

Senator HEINZ. Mr. Chairman, are you opposed to concentration of hearings, too?

The CHAIRMAN. No, no. As a matter of fact, I'm not. If we're to take action this year, we need to concentrate our hearings. I'm going beyond the specifics of concentration or these issues to an issue of State's rights, and I'm puzzled that the IBAA is opposed to individual States. I understand the substance. I'm talking about a concept and a principle now in State's rights. IBAA is saying the States shouldn't have the right to do that if they want to.

Mr. KING. Well, it seems to me that if Congress acts to ratify the State agreements that are being talked about, that it is more or less telling the States that this is what we want you to do, almost pressuring the States to do some of this.

We do have a number of States that are involved in State agreements. I would hope that we do not ratify those positions. I think it's rather odd in one sense.

The CHAIRMAN. Well, the pressure hasn't come from this direction any more than the New England States originated NOW accounts which are now national. Certainly it wasn't my idea and when I made a speech in Connecticut several years ago and they asked my opinion and I said it wasn't important what my opinion was; what was important was what those State legislatures desired to do. And I may disagree with them and so state my opinion.

So if we do ratify that, it is a request coming from six State legislatures, not us going out and saying you form a compact and we will approve it. Mr. King, did you wish to comment?

Mr. KING. Yes, sir, I just wanted to make one comment. It seemed rather odd to me that the regional banks want to have their hunting rights improved at the same time that they want to be protected from the predators from New York and California.

The CHAIRMAN. Well, I understand what you're saying, but you're getting back to substance now rather than principle. I've been trying to get to what State legislatures ought to be able to react, and I think they should. Like I said, my legislature does some things that I think are not wise at times, but I'm going to defend their right to do it.

Mr. Pistor.

Mr. PISTOR. Thank you, Senator. Since our testimony also requested the elimination of title X, it's appropriate I think to comment as to our rationale, and it is simply this; not that the State's rights issue is at the heart of it, but rather, by remaining silent we don't deny the States the rights that they now have. Whereas, if this is included, there is a possibility of introducing a more controversial side of this which would seem to focus on whether or not we have at the national and Federal level therefore legitimatized this more recent approach, an issue which we think can simply be set aside and in setting it aside we really haven't denied those States which want to form reciprocal pacts or compacts. They've taken that already. It just seems to me that there's nothing lost and it might facilitate the legislative process, and we get back in our association to feeling again the urgency of trying to set aside anything that might be controversial.

The **Chairman**. Well, maybe you're right. If we don't make a decision now, the courts will, and I tend to prefer that Congress make decisions rather than the courts because often the courts don't go along with what the intent may be. I believe their insulation and removal from the political process sometimes removes them much too far from the political process.

I also believe that we leave too much to the banking regulators that ought to be legislative decisions. They are doing things right now that I don't believe they should do. Whether I agree with the action or not, it ought to be a policy decision made by Congress. We are too willing to push our decisionmaking to someone else and get away from it, but I understand what you're saying.

Are there any others who wish to comment on that particular issue?

[No response.]

The **Chairman**. Senator Proxmire.

Senator **Proxmire**. I just have one question I'd like to follow up on with Mr. King.

SOUTH DAKOTA SITUATION

Mr. King, do you believe in the principle that one State should be able to set the banking policy for the other 49 and exclude itself, which is exactly what South Dakota did?

Mr. **King**. No, I do not.

Senator **Proxmire**. Here you have a situation where South Dakota determines that National City Bank can come in and establish an office and employ 300 or so South Dakota people and then sell insurance in the other 49 States but not in South Dakota. Now if we follow that principle of State's rights, don't you have a chaotic situation? Won't you have 49 or 50 States for that matter determining national banking policy and affecting the regulation in effect of banks throughout the country in a very chaotic polyglot, unpredictable, eccentric way?

Mr. **King**. IBAA is a State's rights association, but the State's rights have to be within reason. I don't believe that's within reason.

Senator **Proxmire**. Mr. Olsen, would you like to comment on that?

Mr. **Olsen**. We support the provisions of the Garn bill that would speak to that question. We believe that the States do have the right to make their own policy, but support the provisions of the bill that would prohibit a State from authorizing State banks to offer insurance outside the State on a different basis than in the State. We also believe that the question of interstate activities should not be allowed to cloud the issue of expanded products and services.

Senator **Proxmire**. I'm not sure I understand you. Are you telling me that in this particular case of South Dakota and National City Bank, and National City Bank getting into insurance by having South Dakota enable them to do so in the other 49 States but not in South Dakota—do you support that?

Mr. **Olsen**. No, no.

Senator **Proxmire**. You do not support that? You oppose it?

Mr. **Olsen**. That's right.

The **Chairman**. I do not support any State making rules for the other 49. That goes beyond the issue I have been speaking of, but I would comment just for the record that the Governor of South Dakota says that that is misinformation, that their law is written——

Senator **Heinz**. Mr. Chairman, I can give you a direct answer. It will save you meeting with the Governor.

The **Chairman**. I've already had the meeting and I'm only stating his comment that South Dakota is misunderstood on that issue. I'm not editorializing on it. I'm just saying that the Governor of South Dakota said that it is not true, that their law authorizes it in 49 States but not in South Dakota.

Senator **Heinz**. Mr. Chairman, I will debate that with him any time.

The **Chairman**. Well, debate it with him, not with me. I'm simply stating what he told me and will state once again that, despite my eloquent plea, or noneloquent plea, or whatever it was—it was a plea for State's rights, that does not include States that act on behalf of 49 other States but not on behalf of themselves.

Senator Gorton.

Senator **Gorton**. No questions at this time, Mr. Chairman.

The **Chairman**. Senator Heinz.

Senator **Heinz**. Mr. Chairman, thank you.

Mr. Olsen, you were saying that if we didn't grant the additional powers to banks, banks were going to be forced into decline and that businessmen who depend on banks for commercial loans are going to be hurt.

Now my first question is, could you describe the process by which banks are in fact going to decline and, second, if what you say is true, why aren't business people supporting your position?

Mr. **Olsen**. Taking the questions one at a time, as either nonregulated or less regulated competitors enter what has been our traditional banking market, our ability to maintain our capital strength and thus to be able to provide the traditional banking services to the community will be jeopardized.

Senator **Heinz**. Well, that's the general case, but I guess I wasn't clear enough in my question.

If we didn't do anything in terms of giving you powers and we did the fallback of closing the two loopholes we've been talking about, what would happen? How would banks be different 5 years from now? Would there be less of them? There are 14,000 of them today. Would there be less branches? I don't know how many of them there are today. Would electronic banking—and you can find it in every market right now—be accelerated and, if so, to any significant degree? Most branches are going to be replaced, I'm told by the bankers in my State—there are going to be a lot of branches that are closed and replaced by a little stainless steel machine. How are things going to be different? What will the banking community look like so that we can get a photograph of it?

Mr. OLSEN. If nothing were to happen in the way of correcting the current imbalance, the one thing that I can assure you would happen 5 years from now is that banking would not have the ability to meet the needs of its local market to the extent that they do now.

Now I can't describe to you what that market would look like. If you had asked me 5 years ago what it would be like today I'm sure I couldn't have described it accurately.

It is the flexibility to be able to meet the changing needs of the marketplace that's critical to us.

Senator HEINZ. But you are not saying there will be less banks; you are not saying there will be less branches?

Mr. OLSEN. I would think that that would be likely, but I couldn't quantify that.

LESS COMMERCIAL LOANS AVAILABLE FROM BANKS

Senator HEINZ. You are saying there will be less commercial loans available from banks; that's what you're saying. I took that to be the thrust of your earlier testimony.

Mr. OLSEN. The ability of the banks to meet the needs of our customers would be significantly jeopardized if we don't have the ability to offer whatever it is that they are looking for in the financial marketplace.

Now I would say, as it speaks to our traditional services, there are more and more businesses which can enter our traditional markets and commercial lending is one of them.

I would say that there would be more businesses offering commercial loan opportunities in Fergus Falls than there are now and I don't mind that. Our problem is we don't have the ability to provide our customers with additional services to offset what we may lose in that process.

Senator HEINZ. On the one hand, you're saying that the services you now provide will be hurt, and I'm trying to find out, because I think we really ought to know, what kinds of services are likely to be hurt even if we can't predict with accuracy which ones. What kind are likely to be hurt and how is that likely to hurt the consumers or the people who come to your bank to borrow money? Who is likely to get hurt. Obviously, it's not going to be good for the shareholders of the banks. We understand that.

Mr. OLSEN. May I first try to answer that by way of analogy and then be more specific?

As I look at comparing it to a football fan, the Washington Redskins and the Baltimore Colts——

Senator HEINZ. It sounds unfair.

Mr. OLSEN. As each of them look at the upcoming NFL draft, the Washington Redskins can draft from a position of strength. They have the ability to look to the future; they can look for specific gaps that they may have in the future. The Baltimore Colts, I would guess, not being as strong, have to look to the next season and what do we need to do right now.

Senator HEINZ. I'm afraid they look to CBS or ABC.

Mr. OLSEN. I would suggest that that analogy fits the banks. When I look at how our bank is to provide services and meet the needs of the community, I look to what the community might be like 3, or 4, or even 10 years from now. If I'm dealing from a position of less financial strength, I'm more concerned about the immediate impact.

Senator HEINZ. I think we all understand that, quite honestly. I don't think that's at issue at all. I'm trying to get some specificity. I'm not disagreeing with your premise. I'm trying to find out what it translates to with specificity.

Let me ask a totally different question.

Mr. NICHOLSON. Senator, I'd like to respond to that question if I might.

Senator HEINZ. Yes, Mr. Nicholson.

Mr. NICHOLSON. Earlier, I read from an ad that American Express ran that consumers want financial products consistently delivered and tailored to them, and I respectfully submit that's the power we are asking this Congress to give us, so that our organizations can serve our consumers.

I could envision a set of circumstances where we have been denied those powers where we could find the American banking industry in this country without the powers to provide the services the consumer wants, that we will have a second savings and loan situation on our hands, a restricted ability to invest our assets in a narrow band of asset powers. Without the asset powers that the customer wants or the marketplace dictates ought to be had, we won't have the prosperity and the profits in our organization to continue to run it and to serve our cities and our States.

Senator HEINZ. Mr. King, virtually all of you here have been—I'm puzzled by your statement because virtually all of you here have endorsed the separate subsidiary concept under a bank holding company concept, and by endorsing that concept what you're saying is that you will not be free to invest your deposits in the assets of your choosing. That is exactly what that means.

Yet you've just said you have to be free to do that, and I don't understand. You would not have the freedom to invest the deposits of the bank under Senator Garn's legislation, under the Treasury's legislation, you wouldn't have the freedom to invest those deposits in insurance, or in real estate, or in securities. That's not what his legislation contemplates.

Mr. NICHOLSON. Senator, I concur in that comment 100 percent; however, I brought with me on the airplane to read before I go home to present to my board on Monday a report of the Federal Reserve Bank of Kansas City on an examination of my holding company and in the first paragraph the examiners go to the strength and the financial viability of the parent as being the underpinning of the strength of the banking subsidiary and its ability to put in additional capital if the additional capital is required in the bank.

Senator HEINZ. Absolutely correct.

Mr. NICHOLSON. And I submit to you, sir, that the ability to make money in other services and products underpins the strength and soundness of the banking system because it enables the parent holding company to invest additional capital in its subsidiary banks.

Senator HEINZ. That follows QED.

Mr. NICHOLSON. Yes, sir; I hope.

SHOULD BANKS OWN COMMERCIAL ENTERPRISES

Senator HEINZ. Mr. Nicholson, let's get down to the really tough question and you're the person to ask this of, and that is this: do you believe that banks should in fact own steel companies, auto companies, other commercial enterprises? Should we just get rid of Glass-Steagall and end the separation between banking and commerce generally?

Mr. NICHOLSON. That's a question?

Senator HEINZ. Yes, that's a question.

Mr. NICHOLSON. No, we should not.

Senator HEINZ. All right. Why?

Mr. NICHOLSON. Because I think there's a separate and distinct difference between financial services and steel companies, automobile companies, and the list you gave.

Senator HEINZ. What's the nature of that difference?

Mr. NICHOLSON. Financial services.

Senator HEINZ. Well, what's the difference between doing securities underwriting of a steel company and having to support as an underwriter the stock of that steel company and simply investing in a steel company?

Mr. NICHOLSON. I think that that goes beyond the bill in question. The bill in question does not, as I understand it—and I defer to Dick down here—grant any powers whatsoever in underwriting and dealing in securities of commercial corporations.

Senator HEINZ. Well, I'm just asking the question. I didn't say that was in the bill. I'm asking you the question as to what the difference between those two things are.

Mr. NICHOLSON. The difference between corporate securities and municipal securities?

Senator HEINZ. No, underwriting corporate securities of a steel company and actually owning a steel company. I gather what you're saying is that there's no tremendous difference other than one of function.

Mr. NICHOLSON. I didn't say that, sir.

Senator HEINZ. Well, what is the difference?

Mr. NICHOLSON. Well, on the one hand, in owning the companies there's a risk to the shareholders to make it a profitable endeavor. On the underwriting, there's the underwriting risk as to whether you make a proper judgment as to the market accepting the security at the price you offered.

Senator HEINZ. Well, my question, though, would you consider the underwriting of corporate equity or securities or any other corporate securities—would you consider that a financial service or not?

Mr. NICHOLSON. Not of the banking industry, no.

Senator HEINZ. All right. Good. Now what about underwriting insurance. Do you want to underwrite insurance? That's part of Senator Garn's bill.

Mr. NICHOLSON. There is a power in there for underwriting insurance. In my particular company, we might consider underwriting credit, health, life, and accident, which we write quite a bit of.

With regard to casualty insurance, that would be one we would want to take a long look at, speaking personally.

Senator HEINZ. A lot of other people I suppose are wondering how to get out of it. All right.

Now, Mr. Patterson, you said in your testimony as I recollect, that the separate subsidiaries really answer all the problems of tie-ins and a variety of other kinds of problems. Is that true with respect to all activities—insurance, real estate, mutual funds, mortgage revenue bond, and anything else?

Mr. PATTERSON. Well, our association would not have a position on the insurance or real estate ramifications of the subsidiary. We have supported the holding company approach for the new securities activities.

Senator HEINZ. I've got one last question.

Mr. PATTERSON. I don't believe there would be any problem there with tie-ins.

One comment I'd like to make with respect to your statements on underwriting corporates relative to running a steel company, I think there's a big distinction between the role of an underwriter as a financial intermediary and a permanent investment in and running a steel company or an automobile company. One, you're trying to move capital from one place to another as financial intermediary. In the other, you're actually owning it to operate.

Senator HEINZ. Have you ever watched any of the really super-quick corporate conglomerate takeover artists operate and do they really operate any differently than an underwriter? I mean, they are subject to the same kinds of SEC requirements but they are buying and selling companies as if they were underwriters. Just think, in reality, as opposed to in etymology, whether there is a great distinction there.

Let me ask one last question. McFadden and Douglas—and I guess I really want to ask Mr. King and anybody else. Mr. King, it looks like you're the target of all McFadden-Douglas questions.

Thinking now of the membership of your association, thinking about the fact that there are 14,000 banks, and that there is innovation in financial services by banks as well as by other institutions that as I total up the additional markets that would be open to banks as a result of passing Senator Garn's bill or the Treasury bill, it amounts to a small fraction of the total market, the $2.3 trillion roughly now served or acquired by banks, it seems to me inevitable that now that we have deregulated the financial services that banks offer such that they are priced differently, such that the costs are different—you now don't get in effect free money through savings accounts and even checking accounts in some cases, with an unrealistically low federally set regulation Q limit on it—it seems to me that there is going to be, irrespective of what we do here—nothing or everything—great shrinkage in the number of banks.

You know, there are more banks in Western Europe than there are in the Commonwealth of Pennsylvania, and there are 14,000 banks overall.

Now if that picture that I painted is correct, it would seem to me that the best hope of Lockhaven or Williamsport, Pa., to maintain banks in that community is if there is a market and as strong a market as possible for those banks, for their shares, if you will, the extent to which people are willing to bid up the equity of that bank through the marketplace.

Would not, therefore, your members, the shareholders, not the presidents of your banks, but the shareholders of the banks your presidents work for, be best served if there was the largest possible market for the shares of their banks, namely, by making those banks available for acquisition by other banks not necessarily in the State in which they operate, but in regions or nationally? Why wouldn't that be in the interest of the shareholders of the small banks you represent?

Mr. KING. When you phrase the question the way you have phrased it, it sounds positive. I'm not sure that that's the way it really works.

Senator HEINZ. Maybe it isn't. I'm asking the question. You give me the answer.

Mr. KING. The only answer I have is one that I picked up just in the last day or two from a banker in Washington. Washington just recently went to full branch banking throughout the State. This particular banker says that the value of his stock fell from 2.4 times book to 1.3 times book. I think that's a very real possibility.

Banks are up for sale, but branches can be put together much more reasonably. They don't have to be capitalized. They don't have to hire presidents, and a full board of directors, and so on, and they don't have to be totally subservient to the local community that they serve.

Banks usually have a very good market today and in the better locations—you know, two or three times book is not unreasonable. It's not all that difficult to sell a bank.

Senator HEINZ. Mr. Chairman, thank you.

The CHAIRMAN. Thank you very much.

Let me just clarify the line of questioning that Senator Heinz was pursuing which is certainly appropriate, but I don't want anyone to think that this bill does anything with general commerce. He didn't intend that, but it does not, and it does not envision banks owning steel companies, or automobile companies, or anything else. Again, it's an appropriate line of questioning, but I didn't want anybody to leave this room thinking that.

Senator HEINZ. Apparently steel companies can't even own steel companies.

The CHAIRMAN. Well, I agree with the Senator from Pennsylvania that Justice is going down the wrong route on the particular thing that he's referring to and should reverse their position or we should get a new Assistant Attorney General to take care of that particular problem.

Senator HEINZ. Mr. Chairman, you just made a headline.

The CHAIRMAN. Whether I made a headline or not, I'll go a little bit further. It's a little bit difficult to see that you can allow Getty and Texaco to merge and that isn't antitrust, but a couple of relatively small steel companies compared to some others can't. But that is hardly within the scope of these discussions here today.

Gentlemen, we appreciate your testimony very much.

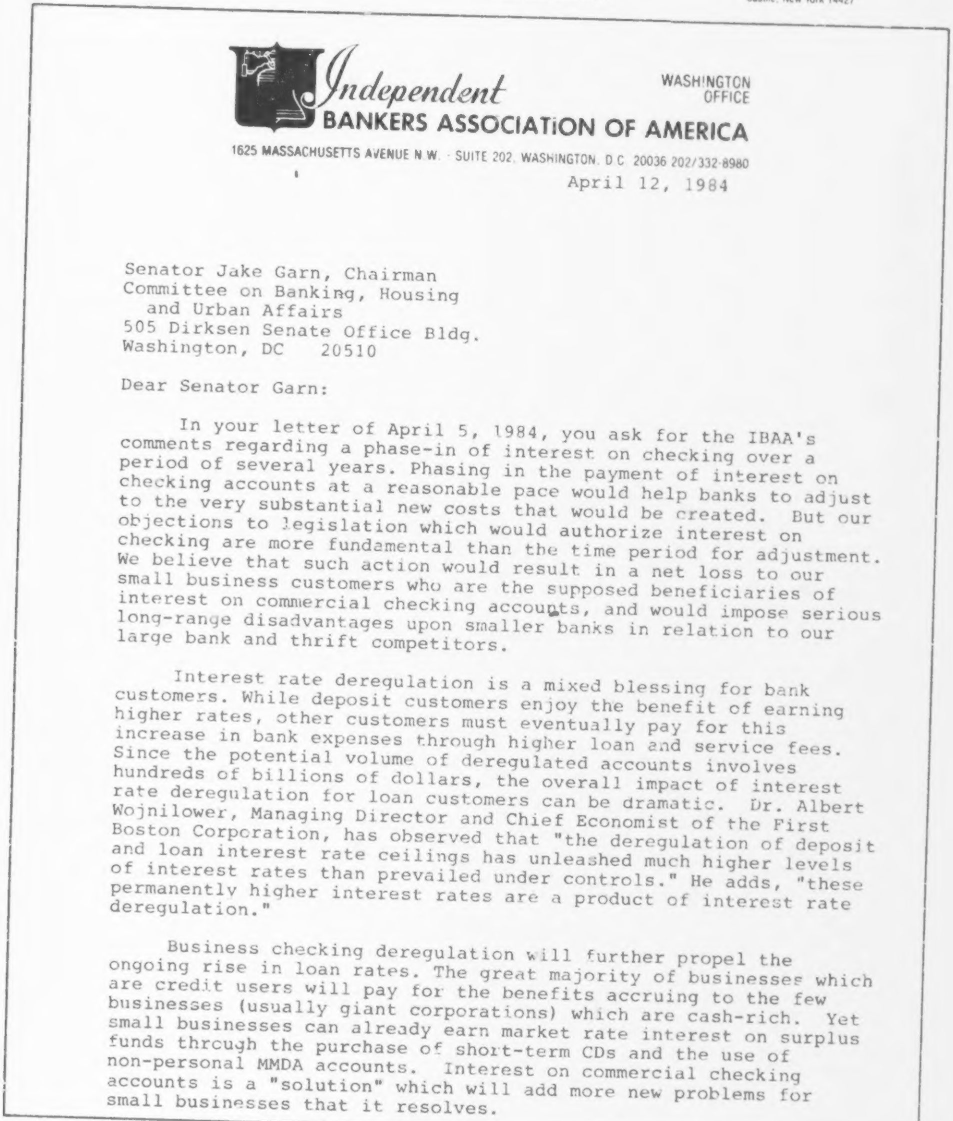
I have so many different questions here that we're certainly not going to be able to get time and I would expect that other members of the committee will have additional questions for your response in writing for the record. Thank you.

The hearing is adjourned.

[Whereupon, at 12:15 p.m., the hearing was adjourned.]

[Response to written questions from members of the committee follow:]

RESPONSE TO WRITTEN QUESTIONS OF SENATOR GARN



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April 12, 1984

Senator Jake Garn, Chairman
Committee on Banking, Housing
and Urban Affairs
505 Dirksen Senate Office Bldg.
Washington, DC 20510

Dear Senator Garn:

In your letter of April 5, 1984, you ask for the IBAA's comments regarding a phase-in of interest on checking over a period of several years. Phasing in the payment of interest on checking accounts at a reasonable pace would help banks to adjust to the very substantial new costs that would be created. But our objections to legislation which would authorize interest on checking are more fundamental than the time period for adjustment. We believe that such action would result in a net loss to our small business customers who are the supposed beneficiaries of interest on commercial checking accounts, and would impose serious long-range disadvantages upon smaller banks in relation to our large bank and thrift competitors.

Interest rate deregulation is a mixed blessing for bank customers. While deposit customers enjoy the benefit of earning higher rates, other customers must eventually pay for this increase in bank expenses through higher loan and service fees. Since the potential volume of deregulated accounts involves hundreds of billions of dollars, the overall impact of interest rate deregulation for loan customers can be dramatic. Dr. Albert Wojnilower, Managing Director and Chief Economist of the First Boston Corporation, has observed that "the deregulation of deposit and loan interest rate ceilings has unleashed much higher levels of interest rates than prevailed under controls." He adds, "these permanently higher interest rates are a product of interest rate deregulation."

Business checking deregulation will further propel the ongoing rise in loan rates. The great majority of businesses which are credit users will pay for the benefits accruing to the few businesses (usually giant corporations) which are cash-rich. Yet small businesses can already earn market rate interest on surplus funds through the purchase of short-term CDs and the use of non-personal MMDA accounts. Interest on commercial checking accounts is a "solution" which will add more new problems for small businesses that it resolves.

In addition to the negative aspects for small business loan customers, interest on checking would create competitive inequities for small banks. Thrifts would gain an entirely new deposit account service, which they could price aggressively without suffering the disintermediation that banks will experience. It will be another major step towards making thrifts into full-fledged "bank" competitors, while allowing them to maintain their special tax advantages, low capitalization, holding company and service corporation privileges, and other regulatory benefits. The large banks have a much smaller percentage of deposits in non-interest-bearing checking accounts, so they have much less to lose if the payment of interest is authorized. In turn, they stand to benefit greatly from the often-discussed "trade-off" of interest on reserves. Small banks carry little in reserves as compared to their volume in demand deposits.

A gradual phase-in of interest on checking does address one of the IBAA's major concerns about such action. The speed with which the DIDC deregulated rates on savings accounts has been a challenge for many banks, and has undoubtedly contributed to the record number of problem banks and bank failures. An overnight conversion of business demand deposits to market rates would add greatly to ongoing bank difficulties. But a phase-in does not address the broader long-range problems of authorizing interest on checking, and does not diminish the IBAA's opposition to such action.

Sincerely,

A. J. King
President

AJK/nls

Responses of the Association of Reserve City Bankers to Question Raised by Senator Garn

a. What should be done with regard to the needs of customers in low income neighborhoods where branches are being closed? What efforts is industry making to ensure that deregulation doesn't result in the removal of financial services from such communities?

The issue of branch closings and expanded products and services is often posed in such a way as to presume that banks should not be allowed to expand their product and service lines unless there are assurances that branches of banks will not be closed in certain, most often low income, neighborhoods. The recommendations of the New York State Commission on Financial Institutions, for example, would appear to be based on such a premise.

The Association of Reserve City Bankers does not believe the two issues of branch closings and expanded products and services should be so linked. The linkage of these two matters in those recommendations has little or nothing to do with the issues involved in each of them separately. And, branch closings, where they have occurred, should not be used as an excuse to deny the public the benefits which will occur from increased competition in the financial services industry through the expansion of bank products and services.

The issue of branch closings is a complex and separate issue which should logically be addressed on its own merits. The closing of branches reflects changes in the marketplace for financial services, not a predetermined decision by bank management to deny certain segments of society access to financial services. The decision to close a branch of a bank is based on a number of important considerations, including the demand for financial services in a particular community, the costs of maintaining a certain branching network, changes in the technology of providing financial services to customers and the competitive environment in which banks and other depository institutions operate.

It should be recognized that the question of branch closings applies only in certain states, since the operation of branches in some states is actually constrained by state law. Indeed, only one-third of the states allow statewide branching. A total of nine states allow no branching at all. The remaining states allow branching on a limited basis. For this reason alone, it would appear illogical to link the issue of branch closings with the expansion of banking products and services since the closing of branches has no relevance at all in some states. To deny the citizens of all states the benefits of competition which will result from the expansion of banking products and services because some banks choose to close a branch would be patently unfair.

In the states where branching is permitted, the decision to operate a particular branch or not in any community is determined by the demand for banking services and the costs of operating a brick and mortar structure. In some communities, the decision to operate a branch or not is an easy one, particularly where the community is growing, the demand for financial services is rising and the costs of operating a branch can be justified. The decision to open or maintain a branch in a community that is in a state of economic decline, on the other hand, is not so easily justified.

Banks, of course, are charged with meeting a convenience and needs test under relevant federal and, and in some instances, state statutes. It must be recognized that this test lends itself to a great deal of subjective judgment. An individual's "needs," for example, often exceed what is affordable. To meet the "needs" of that individual or any group of individuals, in that case, implies a subsidy to assist the individual or group of individuals in purchasing goods and services to meet their "needs," or it implies that those goods and services are given away. The only objective test of "needs" is what is affordable to the purchasers. The willingness or ability of providers to make those services available is a function of their costs.

It should also be pointed out that single-minded adherence to the convenience and needs test under any interpretation of those terms ignores the other statutory or regulatory tests under which banks are required to operate, which usually includes consideration of the adequacy of capital and the prospects for earnings. Banks must not only meet the convenience and needs of the public they serve, they must meet certain other requirements to operate as an ongoing concern and they must concern themselves with the interest of their owners if they are to remain viable institutions.

Unfortunately, conditions in some communities are inadequate to support the establishment of branches or the maintenance of existing branches for a variety of reasons. The current condition and prospects for the future conditions of a community is the result of a factors that go beyond the operation or lack of operation of a bank branch in that community. The establishment of a branch in a community will not be the deciding factor in its growth, nor will the closing of a branch be the deciding factor in the fate of a community under decline. The fate of any community is not contingent on the establishment or maintenance of branches. Those decisions are the reaction to underlying economic conditions, not a cause of them.

It should be recognized that the closing of bank branches is a possible reaction to the deregulation of deposit rate ceilings. The establishment of bank branch networks in many instances was a form of non-price competition engaged in by banks who, of course, were not allowed to engage in explicit price competition because of deposit rate ceilings. Brick and mortar branches were established, in those instances, as a means of competing for deposits, and some banks chose to establish extensive branching networks for that purpose because they were unable to compete by explicitly pricing their services. It is to be expected, therefore, that there will be some branch closings as banks engage in price competition in the absence of deposit rate ceilings.

The closing of a branch, however, does not always indicate that a bank is failing to provide financial services in a community or that the community will do without financial services. Modern technology has allowed banks and other financial institutions to provide those services conveniently through automatic teller machines, the mail or by telephone. In addition, it should be recognized that, just because a bank chooses to close a branch in a community, that community is not being provided financial services by nonbank depository institutions, such as thrift institutions or credit unions, whose financial services have come to resemble more closely those of banks in recent years. Indeed, some of the competition from these institutions, which have become more bank-like, may be forcing commercial banks to close branches in certain areas. Financial services are still being provided in those communities through thrift institutions, credit unions and other financial entities in spite of the decision of a bank to close a branch.

For these reasons, the Association of Reserve City Bankers has approached the question of "What should be done with regard to the needs of customers in low income neighborhoods where branches are being closed?" from a belief that banks should not be forced to maintain branches in certain areas where they cannot be economically justified. They should certainly not be forced to maintain their branching networks in exchange for expanded products and services. Nor did the Association assume the question implied this as a logical, practical or fair step to take.

Nonetheless, the second question of "What efforts is industry making to ensure that deregulation doesn't result in the removal of financial services from such communities?" could be construed to mean that steps to deregulate the financial services industry may not be forthcoming unless assurances can be made that it won't result in the reduction of financial services. We do not believe such a linkage should be made in legislation for the reasons given above.

The closing of branches in any community is symptomatic of economic conditions and changes occurring in the financial system, not the cause of such matters. In view of this, the most important steps which could be taken to meet the financial needs of customers in low income neighborhoods is to assure stable and sustainable economic growth in this country, with specialized efforts directed, where necessary, to reverse trends in neighborhoods where economic decline is underway. Banks and other financial institutions can participate in this process, but they cannot be expected to shoulder the responsibility by maintaining branches in communities where they cannot be justified economically, where alternative sources of financial services are available or where new delivery systems no longer make brick and mortar branches necessary.

While branch closings may occur in communities in response to changes in the financial marketplace now taking place as the result of deregulation of deposit rate ceiling deregulation, we believe that the deregulation of banking on the asset side of the balance sheet, such as now being considered in the form of expanded products and services, will enhance the ability of banking institutions to provide financial services to the public.

Deposit rate ceiling deregulation has increased costs pressures at banks because of the higher costs of deposits. This, in turn, has encouraged some banks to review their opportunities for lowering costs, which in some instances may take the form of branch closings. Enhanced ability to improve earnings through fee income on new products and services would act to mitigate this trend.

b. Bank service fees are another subject of current discussion. Can you provide us with your views of what fees mean to a bank and its customers? How do banks structure their fees? To what extent is this a result of removal of deposit rate ceilings? Are there other ways of increasing earnings? What about the "horror stories" of charging $5 to cash social security checks?

Fees are, obviously, a form of earnings to a bank. They appear in the form of fees on loans or fees on other products and services. These fees comprise a portion of the operating income of banks out of which operating expenses are paid. The difference is net income, which has been declining in recent years.

A bank can earn income in a variety of forms: interest and fees on loans; interest on balances with depository institutions; interest on U.S. government securities, state and local government securities and other securities; fiduciary income; service charges on deposit accounts; other service charges, commissions and fees; and other operating income. Since 1979, when interest and fees on loans comprised 72.1 percent of operating income at all insured commercial banks, the ratio of interest and fee income to all operating income has declined. In 1982, interest and fees income on loans comprised 69.1 percent of all operating income at commercial banks. Service charges on deposit accounts have risen slightly as a percentage of total operating income over that same period, from 1.68 percent of the total to 1.78 percent. Other service charges, commissions and fees were roughly the same percentage of total operating income in 1982 as they were in 1979, and they were lower in both of those years than in 1977 when the percentage was 2.67 percent and in 1978 when the percentage was 2.59 percent.

The operating expenses of commercial banks have climbed considerably in recent years. In 1979, the operating expenses of all insured commercial banks represented 88.1 percent of the total operating income of those banks. The ratio of operating expenses to operating income increased to 89.8 percent in 1980 and to 91.9 percent in 1981. In 1982, the ratio of operating expenses to operating income had risen to 92.6 percent. As a result, the ratio of net income (before taxes and securities gains or losses to operating income) declined from 11.9 percent in 1979 to 7.4 percent in 1982.

Fees represent the explicit pricing of banking products and services to their customers. As is the case with any method of explicit pricing, the fees charged for those allow customers to compare the costs of products and services being offered by competing institutions. Non-pricing competition, on the other hand, does not always allow the customer to comparison shop, since the value of any service may be uncertain, the true cost of obtaining it is unknown or the form in which it is packaged is not entirely satisfactory. Explicit fees for services or products allow the customer to make a decision based on price and pay only for the product being purchased.

Banks have become increasingly engaged in explicit pricing of their products as part of the deregulation effort. To some unknown, but undoubtedly substantial, extent this movement has been encouraged by the deregulation of deposit rate ceilings. Those ceilings prevented banks from engaging in price competition on the liability side of their balance sheets and encouraged banks to engage in nonprice forms of competition to remain competitive. The primary factor behind the structure of fees is the demand for the products and services of banks, the cost of providing those services and the competitive environment in which banks operate. If banking institutions are allowed to engage in new products and services, it would be logical to expect the costs of those services to the public to decline as nonbank companies offering those services then begin to face increased competition.

Bank earnings can be increased one of three ways: (1) increased interest income, (2) increased fee income or (3) decreased costs. It should be noted that operating expenses as a percentage of assets at all insured commercial banks has nearly doubled over the past five years, increasing from 6.3 percent in 1977 to 11.4 percent in 1982. The single most important source of rising operating costs has been the substantial increase which has occurred in interest paid by banks for deposits and borrowed money.

According to a recent study by Arthur Andersen & Co. and the Bank Administration Institute, entitled New Dimensions in Banking: Managing the Strategic Position, interest on deposits and purchased funds will increase to about 73 percent of total expenses by 1990, up from 70 percent presently. According to that report, the increase in interest expense and the corresponding drop in interest income will force banks toward more explicit pricing of other financial services. The report went on to note that noninterest expenses are not expected to decline between now and 1990.

That same report projects that interest income in 1990 will continue to be the dominant source of income for banks, even though it is expected to decline almost one-tenth between now and then to 87 percent of revenues. According to the same report, fee-based income will almost double, but it will represent only 7 percent of total revenues.

In summary, the study by Arthur Andersen & Co. and the Bank Administration Institute suggest that operating expenses, in particular interest expenses, at commercial banks will continue to rise, encouraging banks to price their products explicitly to conform to the price competition they engage in for deposits. The study also suggest that fee income will become a relatively more important, although still a small, part of operating income at banks in the future.

It should also be noted that, according to data prepared by the office of the Comptroller of the Currency, service charges on deposit accounts increased by $2.6 billion between 1978 to 1982. However, interest on time and savings deposits (assuming no growth in deposits) increased by $13.1 billion over the same period. Depositors, therefore, earned a net $10.5 billion in increased interest over and above the increase in service charges on their accounts during that period.

With respect to the "horror stories" of banks charging exorbitant fees for their services, we do not believe such incidences are widespread. The banking industry is a highly competitive one in which institutions charging what customers feel are unjustifiable prices for products and services will not be able to continue doing so for long. Competition among those institutions will encourage customers to take their business elsewhere and it will encourage institutions to lower prices or else lose business. As thrift institutions and credit unions have become more banklike in their products, the degree of competition in the financial marketplace has continued to intensify. And, it will continue to intensify as new competitors enter the marketplace. The public faces a wider range of choices for obtaining financial services than ever before, a trend which will be greatly accentuated in the future through the application of technology in delivering financial services and increased competition. Whatever incidences of overcharging for financial services may have occurred, they can be remedied best by increasing competition in the financial services industry, not by constraining such competition.

Responses of the Association of Reserve City Bankers
to Questions of Senator Heinz

Q. As you know, banks are seeking powers in the areas of:

a. insurance brokerage and underwriting
b. real estate brokerage and underwriting
c. mutual fund sales and underwriting
d. mortgage-backed securities sales and underwriting
e. municipal bond underwriting

Please rank these powers on a scale of 1 to 10 with "1" being virtually risk or exposure free and "10" representing a level of extreme risk or exposure.

A. The Association of Reserve City Bankers believes each of the financial activities listed above pose little or no risk, ranking certainly no more than "2" in any case. In the case of underwriting municipal revenue bonds, the risk involved is certainly no more than that which banks already face in underwriting the general obligations of municipalities. In any case, the risks involved in this and other activities is certainly outweighed by the benefits which the public would reap by allowing banks to compete in these activities.

Banks will vary in their assessment of the risk involved in each of these activities, of course. Perhaps the most comprehensive overall assessment of the risk involved is provided in a study prepared by Arthur Young & Company for the American Bankers Association, entitled Assessment of Business Expansion Opportunities for Banking. We would commend that report to you.

Although that report notes that some new product and services for banking do bear a greater risk than others, we do not believe the risk associated with any of these activities should preclude banks from being given the opportunity to engage in them if they so choose. Banks are involved in risk taking as a normal part of their business activity. They have developed considerable expertise in the management of risk. The Association, itself, has made considerable strides in identifying risks in the nation's payments system and recommending steps which banks can take to mitigate those risks.

Q. Non-banking companies that engage in the activities sought by banks claim that they are at a competitive disadvantage because they do not have access to federal agencies as the lender of last resort nor are they insured by the federal government. Do you agree or disagree with their contention. Please explain your conclusion.

A. Many non-banking companies that engage in the activities sought by banks are already in the same position as bank holding companies due to their ownership of nonbank banks. Those nonbank banks have access to the Federal Reserve and their deposits are eligible for federal insurance. In other words, they are not at any competitive disadvantage relative to bank holding companies. Indeed, they have a competitive advantage over bank holding companies by being able to engage in financial and other business activities not permitted bank holding companies. This is a competitive advantage which the bills presently before the Senate Committee on Banking, Housing and Urban Affairs seek to address.

In addition, other nonbanking companies wishing to engage in banking could do so under those bills, providing they conformed those activities to those permitted bank holding companies. If they chose to do so, they would not be operating under any competitive disadvantage relative to existing bank holding companies.

Q. The suggestion has been made that bank holding companies that engage in non-banking activities should give up their federal insurance and access to federal government loans. Do you agree with this suggestion? If not, why not?

A. The Association of Reserve City Bankers would not agree with this suggestion. For one thing, bank holding companies are not eligible for federal deposit insurance, only accounts in the banking subsidiaries of those holding companies can be insured. Secondly, we do not know of any public policy reasons why such insurance should not be available to account holders in those banking institutions just because the other subsidiaries of the bank holding company, or the holding company itself, are allowed to engage in financial activities approved by Congress or the Federal Reserve. Any company wishing to own a bank and conform its activities to those permitted bank holding companies would be competing on equitable terms with existing bank holding companies. Finally, we note that Chairman Volcker and Secretary Regan testified in support of the objectives being sought in legislation now under consideration by the Senate Committee on Banking, Housing and Urban Affairs without suggesting that banks owned by bank holding companies engaging in other financial activities give up their access to federal insurance or the Federal Reserve's discount window. In the absence of a clear explanation as to why such action would make good public policy, we do not see any justification for it.

Q. Chairman William Isaac of the FDIC has proposed legislation that would permit the FDIC to assess risk-related premiums for banks that engage in lending that has proven too risky. Do you support this proposal? Similarly, would you support a proposal that would require bank holding companies that engage in non-banking activity to pay risk-related premiums?

A. The Association of Reserve City Bankers has not adopted a formal position with respect to the issue of risk-related premiums for deposit insurance. At such time as the Association does consider this matter, we will be happy to provide you with its position. With respect to the second part of the question, we would note again that it is accounts in banks, not bank holding companies, themselves, that are covered by deposit insurance. Interpreting the question to mean such, we do not believe the risk associated with any of the activities now under consideration in the legislation before the Senate Committee on Banking, Housing and Urban Affairs would justify a premium schedule any different from that now in effect.

Q. If no legislation to expand bank powers passed this year, would you endorse proposals to close the so-called non-bank bank and South Dakota loopholes in the Bank Holding Company Act?

A. The Association of Reserve City Bankers has endorsed the closing of the nonbank bank loophole, through a redefinition of a bank along the lines of that proposed in the Administration's proposal and the bill introduced by Senator Proxmire. It has done so, however, only in the context of a larger package of legislative proposals designed to expand the products and services of banking. We have believe this to be the only practical and logical way to proceed. A closing of the nonbank bank loophole raises the same issues as the question of expanding bank products and services, namely what companies can engage in the business of banking. If the loophole is closed as of now, without an opportunity for banking to engage in new products and services, a rather substantial number of nonbanking companies will continue to be allowed to engage in banking even though they are engaged in businesses not permitted bank holding companies. A retroactive date for closing the nonbank bank loophole would have to be sought if it were to be effective. Even then, there would be a large number of companies engaged in a wide array of financial services across industry lines, many of which a banklike in nature even though not offered through a bank. In addition, the retroactive closing of the nonbank bank loophole, with no other provisions in the legislation to expand bank products and services, will deny the public the benefits of increased competition and increased convenience in the financial services industry. In view of this, we continue to believe the most practical course for Congress to pursue is to adopt legislation which redefines the term "bank" and allows banking to engage in products and services that recognize the changes which have already occurred in the financial marketplace.

If bank products and services are not expanded by Congress, this should not preclude the individual states from allowing state-chartered institutions to engage in these or other activities under our dual banking system. States have taken the initiative to authorize such services because of the demands in the marketplace. As a result, the public is being served by such actions, since it is obtaining the benefits of increased competition when seeking such services.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR GARN

THE
CONSUMER
BANKERS
ASSOCIATION

. . . an association for the
retail banking professional

April 16, 1984

The Honorable Jake Garn
Chairman, Committee on Banking,
Housing and Urban Affairs
United States Senate
Washington, D.C. 20510

Dear Senator Garn:

The Consumer Bankers Association is pleased to respond to your additional question for the record in connection with our testimony on February 22, 1984 before the Senate Banking, Housing and Urban Affairs Committee on S. 2181 and S. 2134.

Qualified Thrift Lenders

The CBA believes that the exemption for qualified thrift lenders (QTLs) from the definition of "bank" in S. 2181 would completely remove the barrier between banking and commerce primarily because QTL's would be permitted to invest up to 25 percent of their assets in any type of commercial lending activity. Although unitary thrifts have similar powers under the Garn-St Germain Act, the most critical difference between the two is that unitary savings and loans are currently subject to a 50 percent residential mortgage asset test while a QTL would be subject to a vastly less stringent requirement of either 25 percent of assets in commercial loans or 60 percent of assets in residential real estate loans. As Federal Reserve Board Chairman Volcker stated in his March 27, 1984 testimony before the Committee, "with such a test, 75 percent of all commercial banks today could be treated as thrifts because they have less than 25 percent of their assets in qualifying commercial loans." Furthermore, we agree with the Treasury Department's General Counsel Peter Wallison that

> "while the consumer bank might have been intended to permit nonbanking firms to enter the banking business in a limited way, virtually all such firms will prefer to engage in banking activities through the acquisition or establishment of a qualified thrift lender. The qualified thrift lender would be able to do everything a consumer bank can do, would have five times more commercial lending authority, and would be able to take advantage of the other benefits generally made available to thrifts under current laws." (Legal Times, December 12, 1983)

In sum, CBA believes that the critical difference between a qualified thrift and a unitary savings and loan is in the "either/or" test for exclusion.

Prior to enactment of Garn-St Germain, ownership of a unitary savings and loan by a nonbanking firm was not an attractive venture. However, the lines between a bank and a thrift have recently become blurred in light of commercial banking powers given to thrifts in that Act. Thrifts are no longer specialized lenders, and the current activities of Sears Savings Bank serve as an excellent example. We believe that the banking/commerce division has become outmoded by the realities of the marketplace and that to attempt to stringently maintain its integrity is no longer valid public policy.

If you have any other questions, please do not hesitate to contact us.

Sincerely,

Drew Tidwell

Drew V. Tidwell
General Counsel

Dealer Bank Association

April 17, 1984

The Honorable Jake Garn
Chairman
Committee on Banking, Housing,
and Urban Affairs
United States Senate
Room 534 - Dirksen Senate Building
Washington, D.C. 20510

Dear Senator Garn:

On behalf of the Dealer Bank Association, I am pleased to transmit the Responses to the Questions posed by you and Senator Mattingly, and attached to your letter of April 5, 1984.

The data in the Responses has been taken from statistics prepared by the Public Securities Association.

The DBA appreciates the opportunity to respond to these questions. If we can provide any additional information to the Committee, please do not hesitate to call upon us.

Sincerely,

Richard L. DeCair
Richard L. DeCair
Executive Director

Enclosure

April 13, 1984

RESPONSE OF THE DEALER BANK ASSOCIATION TO WRITTEN QUESTIONS FROM SENATOR GARN

Question: When the banks are involved in the general obligation market today, are they usually the syndicate managers or are they often simply members of the underwriting syndicate? How are the fees parceled out among syndicate members?

Response: Banks today are active as both syndicate managers and members of underwriting syndicates in the general obligation bond market (and in that portion of the revenue bond market which is bank-eligible). In 1982, for example, four of the ten leading underwriters in the general obligation bond market (measured by the identification of the managers) were banks. The same thing is true on a regional basis. For example, in the Mountain States (Arizona, Colorado, Idaho, Montana, Nevada, New Mexico, Utah and Wyoming) in 1982 five of the top ten underwriters in the general obligation bond market were banks.

An analysis of the three largest competitive issues in 1982 confirms that banks are active in the general obligation market, making that market much more competitive than the revenue bond market:

Issuer	Amount	Type	No. of Bids	Managers
Alaska	$200M	G.O.	2	4 banks and 14 broker/dealers
Calif. Dept. Water Resources	$200M	Revenue (not bank eligible)	1	12 broker/dealers
Oregon	$200M	G.O.	3	4 banks and 4 broker/dealers

As the DBA has pointed out before, the participation of banks in the general obligation bond market helps increase the number of bids on municipal issues and thereby helps reduce the interest cost that state and local governments and their taxpayers must bear.

Specific data on the participation of banks in general obligation bond syndicates, otherwise than as managers of syndicates, is not readily available. But a review of the daily "tombstone" advertisements confirms what industry participants know to be the case: both banks and broker/dealers are full and active participants in the general obligation bond market, as managers and syndicate members, together and in competition. A very recent example is the $4.3 billion issue of New York State 1984 Tax and Revenue Anticipation Notes, dated April 12, 1984. A copy of the tombstone from the New York Times for these general obligation bonds is attached. As you will see, there were 14 managers, 7 of which were banks. In addition to the managers, there were 142 other syndicate members, of whom 42 were banks. It is very common, as in this case, for banks and broker/dealers to combine together, as managers and syndicate members, in the general obligation market.

With respect to fees: there is no difference in the customary industry arrangements whether the manager of a syndicate is a bank or a broker/dealer. In competitive bids, there are ordinarily no fees paid to the manager, though the manager will receive a small amount per bond for performing the clearance function. In negotiated transactions, the manager will ordinarily receive a more substantial fee for its work in negotiating the terms of the transaction and organizing the syndicate.

Question: Banks are viewed by opponents of S.2181 as having a cost advantage when participating in an underwriting. When a bank is an underwriter, where does it obtain its underwriting funds? Is this different from other nonbank underwriters?

Response: The charge that banks have some cost of funds advantage in an underwriting is entirely untrue.

First, in the underwriting process, a syndicate ordinarily commits to buy bonds from the issuer and then resells them to the public on a when-issued basis several weeks before actual cash settlements take place. Thus, as a practical matter, no securities need to be carried in inventory in the underwriting process and the cost of funds does not come into play at all.

Second, especially in today's deregulated environment, banks buy funds like any other financial institution, including broker/dealers. When banks take deposits, for example, they pay interest or provide costly services (like check clearing) in return -- a fact that was conceded by the securities industry's own economic expert, Dr. Mussa, during congressional hearings. Moreover, banks must maintain certain noninterest bearing reserves against their deposit liabilities, a requirement that does not apply to broker/dealers.

As a matter of economics, the proper way to view the cost to a bank of funds used for municipal securities activities is to assess the marginal cost of funds purchased by the bank. For those funds, as Dr. Almarin Phillips, Professor of Economics, Law and Public Policy at the University of Pennsylvania, has pointed out, "banks pay market rates and, not infrequently, rates in excess of announced rates on loans to brokers and dealers." The Comptroller of the Currency made the same point in a letter to Congress in 1979:

> The cost of funds argument [made by some broker/dealers] confuses average and marginal cost aspects. The relevant cost figure is the marginal cost of funds for a bank which is generally equal to market rates of interest and may be much higher than its average cost. In fact, the balanced positions of commercial and investment banks in the underwriting of general obligations indicate the lack of any competitive advantage that commercial banks might have over investment banks, and vice versa.

Question: A bank can deduct its interest carrying costs and receive tax exempt income from municipal bonds. When involved in an underwriting, do banks share its cost or tax benefits with other members of the underwriting syndicate?

Response: The DBA believes, for reasons stated below, that there is no significance to what used to be a theoretical difference in the allowance of interest expense as a deduction for banks as compared to broker/dealers. But whatever used to be the case, recent and prospective action by the Congress clearly makes the "tax advantage" issue moot. Specifically, the Tax Equity and Fiscal Responsibility Act of 1982 imposed a 15% disallowance of interest deductions attributable to tax-exempt securities held by a bank, and Congress is now seriously considering legislation to increase the disallowance to 20%. These new provisions undermine the argument that banks have a tax advantage over broker/dealers in the municipal market.

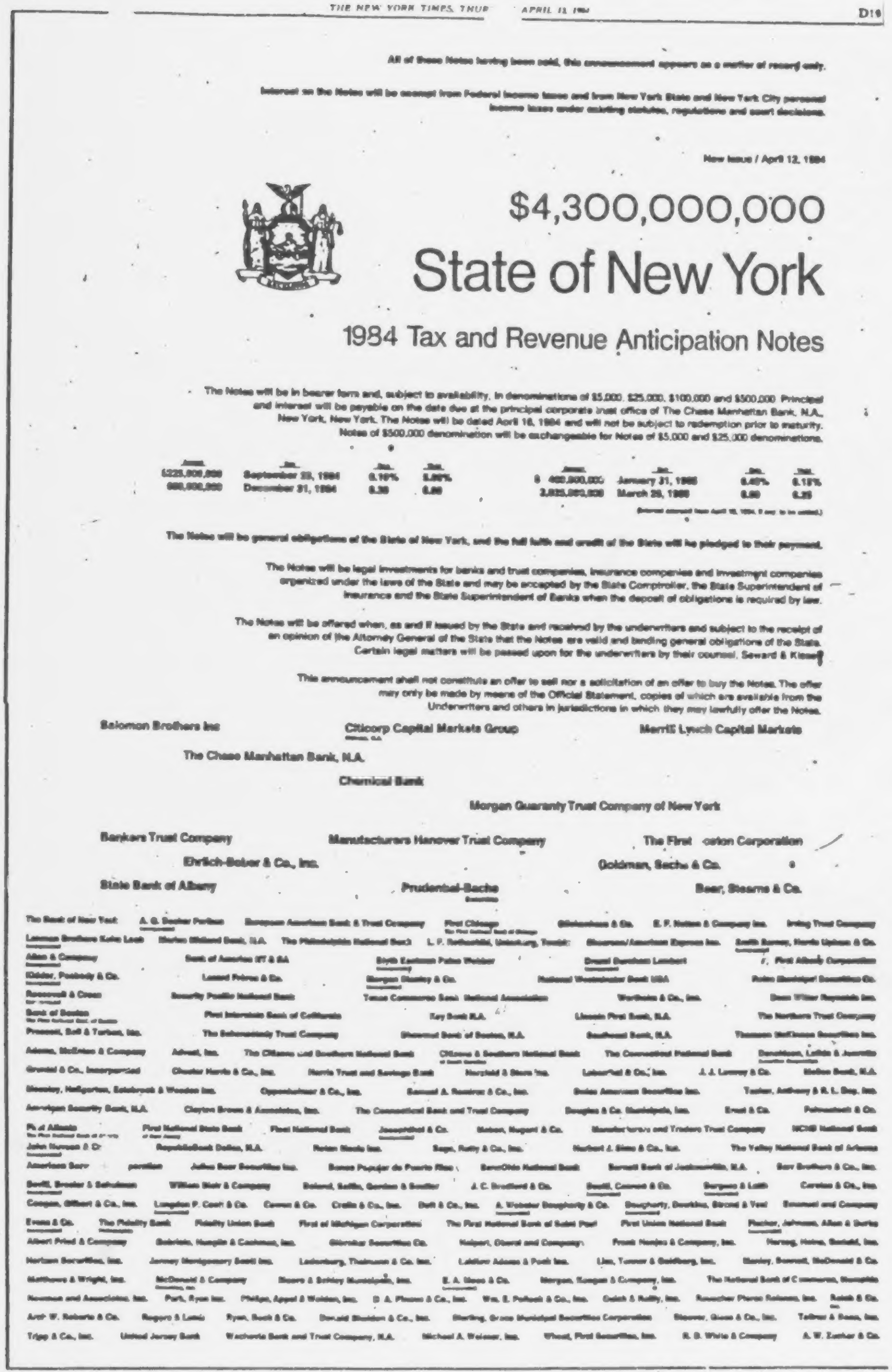
That argument lacked substance in any event. Under the Internal Revenue Code, no taxpayer (whether a bank, broker/dealer, or individual), can deduct interest on indebtedness incurred or continued to purchase or carry tax exempt securities. Thus if a bank incurs indebtedness specifically for the purpose of acquiring tax exempt securities, it cannot deduct the interest costs it incurs. Because banks are in the business of taking deposits for all sorts of purposes, a bank ordinarily used to be able to deduct all of the interest it paid even though, in the ordinary course of its business, it invests in tax exempt securities. Since broker/dealers are not in the business of taking deposits, when they borrow funds and buy or carry tax exempt securities at the same time, they lose the right to deduct the interest on an allocable portion of their indebtedness.

In the underwriting process -- where syndicates of bank and broker/dealers buy securities from municipal issuers and resell them -- it was always plain that there was no practical effect at all from the theoretical difference in treatment. Issues of tax exempt securities are ordinarily sold before delivery, so there is no occasion to finance the securities in inventory, and no tax advantage to anyone. Even when financing was necessary, some dealers regularly opted to take their share of the financing costs in mixed syndicates -- which is their right -- rather than having the banks carry the securities. An economically rational broker/dealer would do this only if it had structured its affairs so as to avoid all or much of the disallowance of interest deductions -- by, for example, allocating its capital to the financing. If broker/dealers could avoid the loss of the interest deduction in this way, there was obviously no tax advantage to the banks.

In any event, in the general obligation and in the eligible revenue bond market, syndicates typically consist of both banks and broker/dealers, and the banks usually financed the securities when that was necessary. The effect of this, of course, was to distribute to the whole syndicate whatever tax advantage existed. And obviously the tax laws do not disadvantage broker/dealers, since broker/dealers hold more than half of the market share in the municipal markets in which banks and broker/dealers compete.

Question: Under S.2181, underwriting would have to be accomplished through a separate holding company subsidiary. Would these tax and cost benefits follow?

Response: For the reasons described in the Responses to earlier Questions, there are no significant cost of funds or tax benefits available to banks in competition with broker/dealers in the municipal market. But even if there were, the provisions of S.2181 would eliminate those advantages by requiring that municipal securities underwriting and trading activities take place in a separately capitalized holding company subsidiary, rather than in a bank (assuming the institution exercised the expanded securitieis powers in the bill). As Mr. Patterson said in his testimony, "the separate subsidiary requirement lays permanently to rest the ancient canards -- undue risk, conflict of interest, tax or regulatory advantage -- that broker/dealers have used in the past as arguments against allowing banks to engage in additional securities activities."



THE NEW YORK TIMES, THUR APRIL 12, 1984 D19

All of these Notes having been sold, this announcement appears as a matter of record only.

Interest on the Notes will be exempt from Federal income taxes and from New York State and New York City personal income taxes under existing statutes, regulations and court decisions.

New Issue / April 12, 1984

$4,300,000,000
State of New York
1984 Tax and Revenue Anticipation Notes

The Notes will be in bearer form and, subject to availability, in denominations of $5,000, $25,000, $100,000 and $500,000. Principal and interest will be payable on the date due at the principal corporate trust office of The Chase Manhattan Bank, N.A., New York, New York. The Notes will be dated April 16, 1984 and will not be subject to redemption prior to maturity. Notes of $500,000 denomination will be exchangeable for Notes of $5,000 and $25,000 denominations.

Amount	Due	Rate	Yield	Amount	Due	Rate	Yield
$225,000,000	September 28, 1984	6.10%	5.80%	$ 400,000,000	January 31, 1985	6.40%	6.15%
600,000,000	December 31, 1984	6.30	6.00	3,075,000,000	March 28, 1985	6.60	6.25

(Interest accrued from April 16, 1984, if any, to be added.)

The Notes will be general obligations of the State of New York, and the full faith and credit of the State will be pledged to their payment.

The Notes will be legal investments for banks and trust companies, insurance companies and investment companies organized under the laws of the State and may be accepted by the State Comptroller, the State Superintendent of Insurance and the State Superintendent of Banks when the deposit of obligations is required by law.

The Notes will be offered when, as and if issued by the State and received by the underwriters and subject to the receipt of an opinion of the Attorney General of the State that the Notes are valid and binding general obligations of the State. Certain legal matters will be passed upon for the underwriters by their counsel, Seward & Kissel.

This announcement shall not constitute an offer to sell nor a solicitation of an offer to buy the Notes. The offer may only be made by means of the Official Statement, copies of which are available from the Underwriters and others in jurisdictions in which they may lawfully offer the Notes.

Salomon Brothers Inc
Citicorp Capital Markets Group Citibank, N.A.
Merrill Lynch Capital Markets
The Chase Manhattan Bank, N.A.
Chemical Bank
Morgan Guaranty Trust Company of New York
Bankers Trust Company
Manufacturers Hanover Trust Company
The First Boston Corporation
Ehrlich-Bober & Co., Inc.
Goldman, Sachs & Co.
State Bank of Albany
Prudential-Bache Securities
Bear, Stearns & Co.

The Bank of New York
A. G. Becker Paribas Incorporated
European American Bank & Trust Company
First Chicago The First National Bank of Chicago
Glickenhaus & Co.
E. F. Hutton & Company Inc.
Irving Trust Company
Lehman Brothers Kuhn Loeb Incorporated
Marine Midland Bank, N.A.
The Philadelphia National Bank
L. F. Rothschild, Unterberg, Towbin
Shearson/American Express Inc.
Smith Barney, Harris Upham & Co. Incorporated
Allen & Company Incorporated
Bank of America NT & SA
Blyth Eastman Paine Webber Incorporated
Drexel Burnham Lambert Incorporated
First Albany Corporation
Kidder, Peabody & Co. Incorporated
Lazard Frères & Co.
Morgan Stanley & Co. Incorporated
National Westminster Bank USA
[illegible] Municipal Securities Co.
Roosevelt & Cross Incorporated
Security Pacific National Bank
Texas Commerce Bank National Association
Wertheim & Co., Inc.
Dean Witter Reynolds Inc.
Bank of Boston The First National Bank of Boston
First Interstate Bank of California
Key Bank N.A.
Lincoln First Bank, N.A.
The Northern Trust Company
Prescott, Ball & Turben, Inc.
The Schenectady Trust Company
Shawmut Bank of Boston, N.A.
Southeast Bank, N.A.
Thomson McKinnon Securities Inc.
Adams, McEntee & Company
Advest, Inc.
The Citizens and Southern National Bank
Citizens & Southern National Bank of South Carolina
The Connecticut National Bank
Donaldson, Lufkin & Jenrette Securities Corporation
Gruntal & Co., Incorporated
Chester Harris & Co., Inc.
Harris Trust and Savings Bank
Herzfeld & Stern Inc.
Lebenthal & Co., Inc.
J. J. Lowrey & Co.
Mellon Bank, N.A.
Moseley, Hallgarten, Estabrook & Weeden Inc.
Oppenheimer & Co., Inc.
Samuel A. Ramirez & Co., Inc.
Swiss American Securities Inc.
Tucker, Anthony & R. L. Day, Inc.
American Security Bank, N.A.
Clayton Brown & Associates, Inc.
The Connecticut Bank and Trust Company
Douglas & Co. Municipals, Inc.
Ernst & Co.
Fahnestock & Co.
First Atlanta The First National Bank of Atlanta
First National State Bank of New Jersey
First National Bank
Josephthal & Co. Incorporated
Mabon, Nugent & Co.
Manufacturers and Traders Trust Company
NCNB National Bank
John Nuveen & Co. Incorporated
RepublicBank Dallas, N.A.
Rotan Mosle Inc.
Sage, Rutty & Co., Inc.
Herbert J. Sims & Co., Inc.
The Valley National Bank of Arizona
American Securities Corporation
Julius Baer Securities Inc.
Banco Popular de Puerto Rico
BancOhio National Bank
Barnett Bank of Jacksonville, N.A.
Barr Brothers & Co., Inc.
Bevill, Bresler & Schulman Incorporated
William Blair & Company
Boland, Saffin, Gordon & Sautter
J. C. Bradford & Co.
[illegible], Conner & Co.
Burgess & Leith
Carolan & Co., Inc.
[illegible], Gilbert & Co., Inc.
Langdon P. Cook & Co.
Cowen & Co.
Craigie & Co., Inc.
Doft & Co., Inc.
A. Webster Dougherty & Co.
Dougherty, Dawkins, Strand & Yost
[illegible] and Company
Evans & Co.
The Fidelity Bank
Fidelity Union Bank
First of Michigan Corporation
The First National Bank of Saint Paul
First Union National Bank
Fischer, Johnson, Allen & Burke
Albert Fried & Company
Gabriele, Hueglin & Cashman, Inc.
Gibraltar Securities Co.
Halpert, Oberst and Company
Frank Henjes & Company, Inc.
Herzog, Heine, Geduld, Inc.
Horizon Securities, Inc.
Janney Montgomery Scott Inc.
Ladenburg, Thalmann & Co. Inc.
Laidlaw Adams & Peck Inc.
[illegible], Tucker & Goldberg, Inc.
Manley, Bennett, McDonald & Co.
Matthews & Wright, Inc.
McDonald & Company Securities, Inc.
Moore & Schley Municipals, Inc.
E. A. Moos & Co.
Morgan, Keegan & Company, Inc.
The National Bank of Commerce, Memphis
Newman and Associates, Inc.
Park, Ryan Inc.
Philips, Appel & Walden, Inc.
D. A. Pincus & Co., Inc.
Wm. E. Pollock & Co., Inc.
Quick & Reilly, Inc.
Rauscher Pierce Refsnes, Inc.
[illegible] & Co.
Arch W. Roberts & Co.
[illegible] & Lewis
Ryan, Beck & Co.
Donald Sheldon & Co., Inc.
Sterling, Grace Municipal Securities Corporation
Stoever, Glass & Co., Inc.
Tollner & Bean, Inc.
Tripp & Co., Inc.
United Jersey Bank
Wachovia Bank and Trust Company, N.A.
Michael A. Weiser, Inc.
Wheat, First Securities, Inc.
R. D. White & Company
A. W. Zucker & Co.

April 13, 1984

RESPONSE OF THE DEALER BANK ASSOCIATION TO WRITTEN QUESTIONS FROM SENATOR MATTINGLY

Question: Trade associations of the securities industry contend that if banks are allowed to underwrite revenue bonds, they will dominate that market. The Glass-Steagall Act, however, permits banks to underwrite general obligation bonds. What percentage of the total general obligation bond market do banks maintain?

Response: The securities industry contention is absurd. Banks and broker/dealers compete fairly in the general obligation bond market today. Banks certainly do not dominate that market. In 1982, six of the top ten underwriters in the general obligation bond market were broker/dealers, while only four were banks. Of the top 50 general obligation bond underwriters, only 13 were banks. These facts dispell the argument that broker/dealers make to try to keep their hold on the revenue bond market -- which, as Mr. Patterson pointed out in his testimony, is a much more concentrated market than the general obligation bond market.

Question: Are revenue bonds substantially riskier than general obligation bonds that banks should not be allowed to underwrite them because of safety and soundness concerns?

Response: Not at all. There are two types of risk posed by debt securities like municipal bonds. One is credit risk: the risk that the issuer will fail to pay principal and interest. Credit risk for revenue bonds is sufficiently small that banks are permitted today to buy and hold revenue bonds for their investment account. Moreover, there is no significant credit risk in the underwriting process since underwriters buy the bonds for immediate resale and do not hold them to obtain interest and principal repayment. The other risk is market risk: the risk of a change in the market price of the securities between the moment the underwriter buys them and the moment it sells them. The market risk in revenue bonds, however, is no different -- and certainly no greater -- than the market risk involved in underwriting general obligation bonds and federal government obligations, which banks have done for 50 years or more without adverse effect on safety and soundness.

The securities industry's "undue risk" argument was laid to rest in an analysis by the staff of the Federal Reserve Board in 1978. The staff recommended that the FRB support legislation permitting banks to underwrite revenue bonds -- as the FRB did then and continues to do. After fully analyzing the "undue risk" argument, the staff concluded that "the assertion that revenue bond underwriting would expose banks and their depositors to undue risks appears to be based in part on a false notion of the relative risks of GO and revenue bonds" and that "[t]he matter of enhanced risk exposure appears to be of least concern."

Since S.2181, S.1609 and S.2134 would all require revenue bond underwriting to be done in a holding company subsidiary, rather than the bank, there is even less basis for the securities industry's argument now than there was in 1978.

Question: What benefits would states, counties and municipalities realize from allowing banks to underwrite revenue bonds?

Response: Allowing banking organizations to underwrite revenue bonds would save states, counties and municipalities -- and their taxpayers -- many millions of dollars. As the Federal Reserve Board has reported to the Congress: "the benefits to State and local governments that would accrue from commercial bank underwriting and dealing in revenue bonds potentially could be of considerable magnitude." That is why state and local governments all across the country, and the public interest associations that represent them in Washington, strongly support the revenue bond underwriting legislation.

The reason that state and local governments would save money if banks were eligible to underwrite and trade in municipal revenue bonds is simply that increased competition provided by banks will assure that costs are reduced to the minimum level, and that the widest possible distribution of securities is available in both the primary and secondary markets. The fundamental premise of our economic system is that increased competition will reduce costs, and that principle is fully applicable to the underwriting and trading of municipal securities.

Exactly how much money states, localities, and their taxpayers would save if the current artificial barrier to bank participation in the municipal revenue bond market were removed is, of course, a matter of some considerable academic dispute. Dr. Phillip Cagan, Professor of Economics at Columbia University, and a member of the Senior Research Staff of the National Bureau of Economic Research, conducted an extensive study sponsored by the Dealer Bank Association, and concluded that the present value of the savings available if banks could underwrite and trade in municipal revenue bonds was in the range of $338-$412 million for bonds sold in 1977. Dr. Cagan's study was bitterly attacked by Dr. Michael Mussa, Associate Professor of Economics at the Graduate School of Business of the

University of Chicago, in a study for the Securities Industry Association. But even Dr. Mussa conceded that there were likely to be at least some savings from bank entry, noting, for example, that "some reduction in borrowing costs would result from reducing the 'excessive profits' that are sometimes earned in one-bid situations."

A very significant contribution to the debate came more recently from Dr. William Silber, Professor of Economics and Finance at the Graduate School of Business Administration of New York University, and Associate Editor of the Review of Economics and Statistics. Dr. Silber did not add a new independent statistical analysis to what he called the "mushrooming literature". Instead, in a study sponsored by the ABA and the DBA, he critically reviewed 12 other studies from 9 different research teams covering market data back to 1959. Dr. Silber's conservative estimate was that, for 1977, the savings for state and local governments from bank eligibility would have been between $80 million and $369 million. As Dr. Silber has said, "the overwhelming weight of the evidence shows statistically significant savings to municipalities if banks were permitted to underwrite additional municipal revenue bonds." Other academic and federal regulatory studies confirm there would be significant savings.

Some savings would be realized by a reduction in the underwriter's profit as more underwriters could compete with each other, and as sales by competitive bid instead of by negotiation with just one syndicate increased. Even more significant savings would come from lower interest rates that issuers would pay. Interest rates would be lower because (a) banks would use their sales forces and contacts to bring additional customers to the municipal revenue bond market, or to match existing investors' needs more accurately to available securities in this highly segmented and complex market; and (b) bank participation in the secondary market would make municipal revenue bonds more attractive and easier to resell after their initial purchase.

Statement
# of the
New York Clearing House Association

S. 2181, The Financial Services Competitive Equity Act; and
S. 2134, The Depository Institutions Holding Company Act Amendments of 1983

Before the
Senate Committee on Banking, Housing
and Urban Affairs
April 1984

The New York Clearing House Association appreciates the opportunity to submit this testimony in connection with the hearings of the United States Senate Committee on Banking, Housing and Urban Affairs on S. 2181, the Financial Services Competitive Equity Act, and S. 2134, the Depository Institutions Holding Company Act Amendments of 1983. The Clearing House is an association founded in 1853 and composed of twelve major commercial banks located in New York City.

A little over ten months ago, John F. Lee, Executive Vice President of the Clearing House, testified on behalf of the Clearing House before the Senate Banking Committee on the pressing need to amend or repeal anachronistic banking laws. The Clearing House continues to believe strongly that it is essential for Congress to revise the banking laws in a meaningful way in response to the radical changes which have occurred and are occuring in the financial services industry and to provide greater convenience and more competition for the public.

At the outset, the Clearing House wishes to express its appreciation to Chairman Garn and the others on the Senate Banking Committee who have recognized the need to address the changes in the financial services industry during this period of rapid transition. Both individual and business users of financial services are increasingly sophisticated and are demanding a wide array of services which banks, in many instances, are prohibited from providing. At the same time, bank competitors -- investment banking firms, insurance companies, retailers and other financial service companies -- can provide many of those services, in addition to banking services, without regulatory or geographic restrictions. Those demands, aided by technological, economic, demographic and competitive forces, have fueled a revolution in the financial services industry.

For U.S. banks to participate fully and effectively in offering the products and services the public is and will be demanding, the present outdated statutory constraints imposed on U.S. banks should be removed. Such constraints are unparalleled in any other sector of our economy and were adopted in response to problems and issues which no longer exist or which have become irrelevant. Many of the services now offered to and demanded by the public were not even imagined or were technologically impossible when the basic legal structure defining the powers of commercial banks was enacted in 1927, 1933 and 1956.

Indeed, the current effect of the constraints placed on U.S. commercial banks is to impede competition -- a function which is diametrically opposed to the underlying rationale of our economic system. Restraint of competition may have the effect of enriching certain segments of the financial services industry, but it clearly denies to the public the benefits to be gained by full and fair competition among all providers of financial services.

In 1981, Gordon Wallis, then the president of the Clearing House, in testifying before the Senate Banking Committee, characterized the financial services market as composed of two types of competitors -- "unregulated companies able to provide virtually every financial service demanded by the public and regulated banks able to provide only limited financial services". He compared the services that U.S. banks could offer with the services that their competitors offered, and concluded that a non-bank competitor could do everything a bank could do and much more.

He observed that, in addition to offering all the services that a bank could offer, an unregulated financial services company such as Merrill Lynch or American Express could also underwrite and deal in all securities, and provide full-scale brokerage, insurance and real estate services -- and offer these services on a nationwide basis. Mr. Wallis also observed that a U.S. bank could not embark on a meaningful expansion of services without an extensive application process, often involving delay. During subsequent testimony before the Senate Banking Committee in June 1983, the Clearing House described how this disparity between banks and other institutions has grown; today this trend continues.

For example, Sears Roebuck & Co. continues to develop as one of the country's largest providers of financial services. Sears operates 168 in-store "financial centers" in various of its merchandising outlets and expects to have 283 financial centers open by the end of the year. In California, a Sears retail customer can buy, at one of those financial centers, life, casualty and home insurance, money market funds, or a condominium, obtain a loan and make deposits into a savings and loan institution, while at the same time buying and financing a washing machine in the home appliance department of Sears' retail store. Newspaper reports indicate high consumer acceptance of these integrated services due to convenient locations and business hours, among other factors.

Merrill Lynch has developed an equity access home loan product which operates in conjunction with a Merrill Lynch money market fund -- essentially allowing Merrill Lynch to accept deposits from a customer while making consumer loans. At the same time, Merrill Lynch is testing a program in which a customer can direct deposit his paycheck and Social Security payments into his Merrill Lynch money market fund. Finally, Merill Lynch has established a "non-bank" bank in New Jersey.

Likewise in mid-March, E.F. Hutton began taking its first deposits through its new "non-bank" bank, while at the same time Prudential Insurance Company of America announced the offering of "jumbo" certificates of deposit through its subsidiary, Prudential Bank and Trust Company. In the case of the Prudential CDs, part of the insurance coverage will be provided by another Prudential subsidiary.

More recently, Shearson/American Express, already one of the nation's major financial concerns, announced it would acquire Lehman Brothers Kuhn Loeb Inc., one of the nation's largest investment banking houses. The combined company will offer securities, insurance, banking, real estate, credit cards and travel services.

As the foregoing examples so vividly illustrate, meaningful legislative reform is essential if banks are to remain viable competitors in providing financial services on a national and worldwide basis. The need for remedial legislation has become acute. There is presently pending before Congress a wide variety of banking bills, including the Financial Services Competitive Equity Act (S. 2181), which address changes in the financial services industry. S. 2181, in particular, contains provisions relating to the areas that we believe must be addressed by this Congress and we generally endorse those provisions. The experience of banks in successfully providing the limited underwriting and agency services that are presently permissible confirm that such activities are not unduly risky for a bank. While the Clearing House endorses S. 2181 which provides additional powers, we note that our members are not unanimous in accepting S. 2181's requirement that certain newly-authorized financial services be performed in a bank affiliate as opposed to the bank itself.

We strongly urge broad-based and extensive revisions to the banking laws as soon as possible, particularly those reforms which would allow banks to offer a full range of financial services to the public, including dealing in and underwriting revenue bonds and mortgage backed securities and offering mutual funds, insurance and real estate services. We also urge immediate legislative action to amend the Bank Holding Company Act to simplify and streamline procedures for regulating bank holding companies. In addition, the Clearing House strongly opposes any Federal ratification of discriminatory regional interstate banking arrangements.

UNDERWRITING ACTIVITIES

With respect to the underwriting activities contemplated by the Financial Services Competitive Equity Act (S. 2181), it is particularly noteworthy that banks today provide similar underwriting services, that these services have been provided for many years, and that no bank has experienced problems as a result. Also, because the securities in question were either non-existent or minimal in 1933, the present inability of banks to underwrite them results from Congress' failure to monitor the evolution of the financial services industry rather than a conscious concern about economic harm. In 1933, when the Glass-Steagall Act restrictions on bank underwriting were imposed, the overwhelming preponderance of municipal bonds were general obligations and not revenue bonds. As municipalities and state agencies subsequently expanded the scope of their responsibilities and obligations, however, they increasingly turned to innovative forms of revenue-based securities to finance these activities. Today, revenue bonds represent over 70% of all municipal obligations.

So long as Glass-Steagall precludes banks from underwriting these securities, municipalities will be unable to obtain the lowest financing costs which competition would provide, and their citizens must bear the burden in terms of reduced services, higher taxes, user fees or a combination of such burdens. Banks have obviously developed substantial expertise in underwriting municipal general obligation securities and the limited types of revenue bonds that are bank eligible, and this expertise can be applied easily to other types of revenue bonds.

Congress has recently shown its concern in another area of our economy, the need to provide and maintain adequate housing and to encourage construction towards that end. Allowing banks or bank holding companies to underwrite and deal in mortgage-backed securities will augment liquidity in the primary mortgage markets; thus advancing the construction of housing. Banks have also developed expertise in the underwriting of securities for the construction of hospitals, schools and dormitories, and this expertise can be applied to mortgage-backed securities. In short, expanding underwriting powers as contemplated by S. 2181 would assist sectors of our economy which most need the benefits that would result from enhanced competition -- including new and expanding businesses, health service organizations, educational institutions, transportation facilities and housing.

REAL ESTATE AND INSURANCE

Allowing bank holding commpanies to offer real estate and insurance services will permit banks to provide greater convenience and more alternatives to the public and to compete with other financial services companies such as Merrill, Lynch; Prudential-Bache; Shearson/American Express, and Sears Roebuck Company.

All three of these companies offer real estate as well as other financial/banking services. They have done so without raising grave concerns about concentration of our economic resources or about undue influence on consumer choices. Any potential concerns relating to subtle pressures on the consumer are the same in degree and kind whether the customer is purchasing his house and financing its purchase through subsidiaries of a bank holding company or a financial services company. Moreover, as noted by Chairman Volcker in his testimony before this Committee, the ability to engage in real estate brokerage does not raise issues of undue risk to the banking system.

With respect to real estate development activities, banks simply cannot remain competitive insofar as their commercial loan portfolio is concerned without obtaining the benefits which may be realized through equity participation in real estate projects. In this area banks are competing with financial services companies which are able to offer attractive terms to potential borrowers by combining real estate development and real estate financing activities. This works to the ultimate advantage of both the user and the provider of these services.

Turning to insurance powers, New York State's Temporary Commission on Banking, Insurance and Financial Services recently recommended a broad restructuring of the financial services industry in New York. Key to the recommendation was a proposal that all banks be permitted to sell insurance and that insurance companies (and securities firms) be allowed to acquire or establish banks. The Commission concluded that if the proposal were accepted, the consumer would benefit through more choices in obtaining financial services, the convenience of one-stop shopping, and the lower costs resulting from increased competition. Moreover, product diversification would enable banks to provide financial services at locations which might not on their own justify a branch location. With the resources, technology and personnel already in place, banks could readily handle the additional transactions.

Recent experiments have served to provide some of these advantages in part to the consumer. For example, the Equitable Assurance Society of the U.S., the nation's third largest life insurance company, is reported to have entered into an agreement to offer some insurance products at a branch of Alaska Mutual

Bank, Anchorage. Similar arrangements are said to be planned for other states. The impetus for the program apparently was a desire to meet customer demands for "complete financial packages". Similarly, Bank of America and Capital Holding Company ("CHC") have a pilot program in which CHC has a physical presence in the bank's branches.

In short, permitting banks to provide a wider range of financial services would better enable commercial banks to meet consumer demands for those financial services. This would extend the benefits of increased competition to American consumers.

AMENDMENTS TO SIMPLIFY APPLICATION AND APPROVAL PROCEDURES

Turning to procedural deregulation, the Clearing House supports the amendments to paragraph 8(B) of Section 4(c) of the Bank Holding Company Act (12 U.S.C. 1843(c)) contained in S. 2181 which would simplify and streamline application and approval procedures which apply to a bank holding company. The present procedures have proven to be unnecessarily time consuming and can be extremely costly. Although the Federal Reserve Board's recent revision of Regulation Y has reduced the procedural burden, further simplification requires Congressional action.

The duplicative levels of regulatory and judicial review, which would be simply curtailed by proposed paragraph 8(B) has been particularly burdensome and wasteful. In one instance, a member bank applied to open a data processing subsidiary that would perform an activity which has been placed on the Federal

Reserve Board's Regulation Y "laundry list" of permitted activities. It has been four years since it filed that application with the Board and even after Board approval, the bank has been unable to open the subsidiary because it has been involved in litigation over the matter with a special interest group seeking to prevent such activity. Therefore, simplifying and streamlining the application and approval process would have several beneficial results: it would reduce the Federal Reserve Board's administrative burden; it would significantly reduce unnecessary administration and litigation costs now incurred by banks; and it would hasten increased competition in the provision of financial services.

INTERSTATE BANKING

Lastly, the Clearing House firmly opposes the passage of any federal legislation which would ratify discriminatory regional interstate banking arrangements, including the provision contained in Title X of S. 2181. It remains our view that the archaic and unprecedented restrictions imposed on interstate banking should be removed by Congress as quickly as possible. In the absence of Congressional action, state laws which permit interstate banking on a nondiscriminatory basis, such as those in New York, Maine, Alaska, South Dakota and Delaware, are beneficial to the public and the banking system alike.

Congress should not, however, place a federal imprimatur on state statutes which openly discriminate against sister states and arbitrarily divide natural market areas. The framers of the United States Constitution enacted the Commerce Clause to prohibit economic balkanization of the very type embodied in these state statutes. That prohibition has been zealously guarded by the Supreme Court, starting with the landmark decisions by Justice Marshall.

CONCLUSION

In conclusion, it is essential that legislative reforms make it possible for banks to compete in offering financial services for the public benefit. The wide array of products and services demanded by present-day users will be provided at the cheapest price, most abundantly and most competitively when the archaic, artificial barriers to competition enacted in another era are at last removed.

COMPETITIVE EQUITY IN THE FINANCIAL SERVICES INDUSTRY

PART II

TUESDAY, FEBRUARY 28, 1984

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, D.C.

The committee met at 9:30 a.m., in room SD-538, Dirksen Senate Office Building, Senator Jake Garn (chairman of the committee) presiding.

Present: Senators Garn, Mattingly, and Hecht.

OPENING REMARKS OF CHAIRMAN GARN

The CHAIRMAN. The Banking Committee will come to order.

We are continuing today the hearings on S. 2181 and S. 2134, the Financial Institutions Deregulation legislation.

Our first panel before us today is composed of John B. Zellars, chairman and president, Georgia Federal Savings Bank, Atlanta, Ga.; vice chairman, U.S. League of Savings Institutions; Mr. M. Todd Cooke, chairman, Philadelphia Savings Fund Society; chairman, National Council of Savings Institutions; and Mr. William B. Muse, Jr., president, Imperial Savings & Loan, Martinsville, Va.; chairman, American League of Financial Institutions.

Mr. Zellars, would you like to begin, please?

STATEMENT OF JOHN B. ZELLARS, CHAIRMAN AND PRESIDENT, GEORGIA FEDERAL SAVINGS BANK, ATLANTA, GA.; VICE CHAIRMAN, U.S. LEAGUE OF SAVINGS INSTITUTIONS

Mr. ZELLERS. Thank you, Mr. Chairman.

Mr. Chairman, members of the committee, my name is John B. Zellars. I am a savings institution executive from Atlanta, Ga., and am appearing here today on behalf of the U.S. League of Savings Institutions. The league and its members welcome this opportunity to present our views on Chairman Garn's S. 2181 and Senator Proxmire's S. 2134. To save time, I will keep my oral remarks brief, but we ask that our entire written statement appear in the record.

Before proceeding further, I wish to emphasize the enormous importance to our industry of the landmark Garn-St Germain Depository Institutions Act. As intended, it has given us the flexibility we need to continue our longstanding concentration on housing finance. That the act is functioning properly is dramatically shown by the estimated $137 billion in mortgages originated by our industry in 1983. This was a new record, and refutes those who predicted that a modest grant of commercial lending power would lead us to abandon housing. We sincerely thank this committee for having recognized our commitment to housing, and providing us with tools to help strengthen that commitment.

REENDORSEMENT OF PRINCIPLES EMBEDDED IN GARN-ST GERMAIN ACT

Looking at S. 2181 and S. 2134, the U.S. League is extremely pleased that both reendorse the principle, firmly embedded in the Garn-St Germain Act, that possession of a degree of commercial lending authority does not transform our institutions into commercial banks.

This principle found its primary expression in the act in its treatment of unitary S&L holding companies, which traditionally have had no activities restrictions. The act continued this freedom—on one condition: the savings institution subsidiary had to be sufficiently housing-oriented to pass an asset composition test that institutions must meet to get the tax benefits given home mortgage specialists by the special bad-debt deduction.

An asset composition test represents, in our view, the most logical and equitable way to distinguish for regulatory and empowerment purposes between savings institutions and commercial banks. First, it is founded on the sensible premise that financial institutions should be regulated on the basis of what they actually are doing, rather than what they possibly could do under statutorily available options. In this regard, even with our new investment authorities, there are very substantial differences in activities between the typical savings institutions and the typical commercial bank, with its predominant focus on commercial credit.

Second, it offers each institution's board of directors and management the freedom to determine their future direction. Freedom to choose the system under which to live and work is the basis of our political system and is also the thrust of the deregulating effort of recent years.

Regarding the specifics of an asset test, we believe that it must be consistent with the Garn-St Germain Act objective of providing savings institutions with the investment flexibility they require to remain housing specialists in a deregulated environment. Savings institutions that preserve their primarily housing finance character should be allowed to maintain the holding company and other flexibility they traditionally have had as a counterweight to the earnings risk that has accompanied residential real estate concentration.

Comparing the tests in the two bills, we believe the 60 percent housing-based test contained in S. 2181 is more flexible and thus preferable, and appears generally well suited for use as a boundary marker—provided that several vital modifications are made.

First, no provision is made for including liquidity items. We consider this a serious omission. Investment in liquid assets is central to a savings institution's continued ability to function as a depository and deliver mortgage credit—particularly with respect to its eligibility for the housing support flowing from Federal Home Loan Bank membership.

The S. 2181 test also needs to be modified to recognize the contribution of savings institutions that originate mortgage loans and sell them in the secondary market.

Finally, any asset test employed should make special provisions to deal with the transitional problems of savings banks.

In the time remaining, I'd like to mention five additional areas of concern.

First, let me stress that we are pleased that S. 2181 does not reflect the hostility and lack of understanding displayed toward service corporations by the Treasury Department's bill last summer. Service corporations have provided extremely important earnings support in recent years—support that was especially needed during the thrift crisis. We would oppose legislation that attempted to deprive our industry of this source of strength.

Second, in the event bank holding companies receive new powers, the U.S. League regards it as essential that mutuals be provided with additional service corporation authority to permit them to compete. We suggest that savings institutions be given special service corporations as vehicles for competition in any new areas opened up for bank holding firms.

Third, we strongly object to the fact that real estate investment and development by multiple S&L holding companies would be limited to 5 percent of primary holding company capital and could not include any form of construction activity. Savings institutions have acquired considerable knowledge and experience in real estate investment and development—including construction—and we fail to see the basis for any drastic cutback.

As a fourth matter, we enthusiastically support S. 2181's elimination of the longstanding ban on paying interest on demand deposits. We strongly suggest as an additional matter that the demand deposit authority available to Federal associations be conformed to that available to commercial banks. The current restriction that limits our checking account service to businesses to those which have a loan relationship and effectively prevents us from offering checking deposits to individuals interfere with our efforts to serve our communities.

Finally, after detailed legal review, we believe that we need authority for a special-purpose mortgage securities subsidiary if we are to participate fully in the emerging world of mortgage-backed securities. We hope this committee looks with favor on this request if the House sends back your Secondary Market Enhancement bill.

Mr. Chairman, this concludes my oral remarks. If you have any questions concerning them or our written statement, I will be happy to try to provide some answers.

Thank you.

[The complete statement follows:]

STATEMENT OF JOHN B. ZELLARS
ON BEHALF OF THE UNITED STATES LEAGUE OF SAVINGS INSTITUTIONS
TO THE SENATE COMMITTEE ON BANKING, HOUSING & URBAN AFFAIRS
February 28, 1984

MR. CHAIRMAN AND MEMBERS OF THE COMMITTEE:

My name is John B. Zellars. I am Chairman of the Board and President of Georgia Federal Bank, FSB, a savings institution located in Atlanta, Georgia, and appear here today in my capacity as Vice Chairman of the U.S. League of Savings Institutions. The League and its 3500 savings and loan and savings bank members welcome this opportunity to present our views on S. 2181, the Financial Services Competitive Equity Act, and S. 2134, the Depository Institutions Holding Company Act of 1984, introduced, respectively, by Chairman Garn and Senator Proxmire of this distinguished Committee.

Both bills deal with important questions relating to the delivery of financial services and the regulatory framework governing the institutions that deliver those services. For the sake of brevity, I will focus my detailed remarks primarily on the structural-type issues raised by Title I of S. 2181 and by S. 2134.

GARN-ST GERMAIN ACT FUNCTIONING PROPERLY

Before proceeding further, however, Mr. Chairman, I wish to emphasize the enormous importance to our industry of the changes in our investment and other authorities made by the landmark Garn-St Germain Depository Institutions Act, Public Law 97-320. That legislation has been absolutely central to our restructuring efforts, giving us, as was the Act's intent, the asset-side and other flexibility we need to continue our strong, long-standing concentration on housing finance. The effective functioning of the Garn-St Germain Act is graphically demonstrated by the fact that savings institutions in 1983 originated an estimated $137 billion in mortgages -- a new record, and a telling refutation of the argument that the modest grant of commercial lending authority provided by P.L. 97-320 would cause our institutions to forsake their traditional housing speciality. Mr. Chairman, we sincerely thank you for having recognized the depth of our commitment to housing, and for having worked so effectively to provide us with tools to help perpetuate and strengthen that commitment.

BILLS RECOGNIZE DIFFERENCES BETWEEN BANKS AND SAVINGS INSTITUTIONS

Looking at the legislation under consideration, the U.S. League wishes at the outset to express its pleasure that S. 2181 and S. 2134 reendorse the principle, firmly embedded in the Garn-St Germain Act, that mere possession by savings institutions of a degree of commercial lending authority does not somehow transform them into commercial banks or justify their being regulated as such. This principle found its primary expression in P.L. 97-320 in that measure's treatment of unitary savings and loan holding companies, which traditionally have not been subjected to any activities restrictions. The Act permitted this flexible regime to continue for unitaries, notwithstanding commercial lending authority, provided the holding company's savings institution subsidiary remained sufficiently housing-oriented to pass an asset composition test found at section 7701(a)(19)(C) of the Internal Revenue Code. Savings institutions meeting that standard may utilize a bad-debt deduction contained in section 593 of the IRC. If a subsidiary is unable to meet the test, the holding company must comply with the activities restrictions applicable to multiple savings and loan holding companies -- limitations very similar to those affecting bank holding companies.

S. 2181 would confirm the approach of using an asset composition test -- albeit not the one used in the Garn-St Germain Act -- to determine when savings institutions which are part of a holding company structure have strayed sufficiently far from a residential real estate specialization to justify imposing narrow bank holding company-like restrictions. It would apply this asset test in the service corporation area as well. Savings institutions meeting the test and thus enjoying continued holding company and service corporation flexibility would be termed "qualified thrift lenders." S. 2134 would use an asset composition test only as a determinant of S&L holding company flexibility.

LEAGUE SUPPORTS APPROPRIATE ASSET COMPOSITION TEST

Although, as I will discuss shortly, we believe the tests employed in the bills must be modified in important respects, the U.S. League is convinced that the asset test represents the most logical and equitable way to distinguish for regulatory purposes between savings institutions and commercial banks. First, it is founded on the sensible premise that financial institutions should be regulated on the basis of what they actually are doing, rather than what they possibly could do under statutorily-available options.

In this regard, even with the new investment authorities given our industry by the Garn-St Germain Act, there are very substantial differences in activities between the "typical" savings institution, primarily oriented toward residential real estate, and the "typical" commercial bank, with its predominant focus on commercial credit. Certainly our new, and limited, commercial lending authority has in no sense resulted in financial institution homogenization. By year's end 1983, commercial loans in the aggregate comprised roughly one-half of one percent of our assets, while residential real estate lending soared to record levels. These facts belie any assertion that a process of homogenization is underway.

Because the differences between savings institutions and commercial banks are based primarily on investments, the composition of a depository's assets provides a readily quantifiable measure of the location of each in the depository institutions continuum, and thus offers an excellent means for determining whether an institution should be subject to regulations suitable for entities devoted principally to commercial lending, or those covering depositories primarily concerned with residential real estate. To reiterate, the asset compositon test approach -- assuming the test is properly crafted -- assures that regulation will reflect the real-world behavior of institutions, as opposed to the hypothetical possibilities open to them.

The second basic reason that the U.S. League supports the use of an appropriate asset test is quite simply that it would offer to each institution's board of directors and management the freedom to determine their future direction within our diverse and specialized financial system. Freedom to choose the system under which to live and work is the basis of our political system and is also the thrust of the deregulation effort of recent years.

APPROPRIATE COMPONENTS OF ASSET COMPOSITION TEST

In terms of the particulars of an asset composition test, we believe that the test as a fundamental matter must be consistent with the Garn-St Germain Act objective of providing savings institutions with the investment flexibility they require to remain housing specialists in a deregulated funds-acquisition environment. Savings institutions that do maintain their primarily housing-finance character should be allowed to maintain the holding company and other flexibility they traditionally have had as a counterweight to the earnings handicaps associated with a residential real estate concentration.

As noted previously, the Garn-St Germain Act endorsed this viewpoint, permitting, inter alia, unitary SLHC flexibility to continue as long as the depository subsidiary met a test found at section 7701(a)(19)(C) of the tax laws. To be eligible for this tax treatment, an institution is required to maintain the amount of its "qualifying assets" at a level equal to 60 percent or more of its total assets. Qualifying assets include such things as: residential mortgage loans; church loans; educational loans; mortgage-backed securities issued by the Government National Mortgage Association, the Federal National Mortgage Association, or the Federal Home Loan Mortgage Corporation; liquidity items such as cash, Treasury securities, and federal agency issues; and property used in the institution's business.

The League has considered carefully the continued suitability of this test for its current function under the Garn-St Germain Act, as well as in terms of possibly marking a general boundary between the savings institution and commercial banking industries. We believe it is reasonably well adapted to both tasks. It has the advantages of being familiar and of demonstrated acceptability to Congress, specifically oriented to promoting the housing specialization function that is the hallmark of our industry, and flexible enough -- granted certain adjustments -- to permit savings institutions to use their new investment powers to assure their continued presence in the housing credit markets at all points in the economic cycles.

With respect to adjustments, the U.S. League is convinced that, in order to recognize the totality of our industry's commitment to housing, as well as the broader range of instruments now qualifying and utilized for liquidity purposes, the section 7701(a)(19)(C) test should be updated to add the following investments as qualifying assets:

1. All domestic investments, whether loans or equity positions, related to residential real estate, encompassing:
    (a) All investments related to shelter-providing facilities, including, for example, hospitals, nursing homes, and student dormitories and residences;

(b) All investments in home equipping or improvement loans;

(c) All investments in mortgage-backed securities, both of the asset participation and pay-through bond type; and

(d) Qualifying assets held by a depository institution's subsidiary; and

2. All investments in items qualifying as legal, short-term liquidity pursuant to regulations issued by the Federal Home Loan Bank Board under section 5A of the Federal Home Loan Bank Act.

As an additional and very important matter, we consider it imperative that the tax code test not be structured to disadvantage organizations operating in a mortgage banking mode. A savings institution that originates home loans beyond its own balance sheet carrying capacity and, therefore, sells them on the secondary market still shows a continuing commitment to housing that should be reflected in any update of the present Internal Revenue Code language.

Logically, of course, these changes and the test itself should be reflected in statutory language located in the Home Owners' Loan Act or the National Housing Act, rather than cross-referenced to the Internal Revenue Code. As a final point, we do believe there would be considerable merit in modernizing the section 7701(a)(19)(C) asset test for tax purposes, as well as for industry-demarcation purposes. We appreciate, of course, that tax changes are not within the jurisdiction of your Committee.

S. 2181 ASSET COMPOSITION TEST

S. 2181 would deal with the asset test question by allowing savings institutions to be treated as "qualified thrift lenders," and thus retain current unitary holding company and service corporation authority, if they meet one of two alternative tests. Under the first, an institution could qualify by having not more than 25 percent of its assets (including loans made by an subsidiary) in commercial-type loans, and not exceeding such percentage on an average basis in three out of every four quarters and two out of every three years. Under the second, a savings institution would attain thrift lender status by having an aggregate of not less than 60 percent of its assets (including investments made by any subsidiary), invested in loans, equity positions, or securities related to domestic residential real estate or manufactured housing, and in property used by the institution in the conduct of its business, and by not falling below that percentage on an average basis in three out of every four quarters and two out of every three years. Any institution losing qualified thrift lender status could not thereafter regain it for a period of five years.

PROBLEMS WITH USING A COMMERCIAL-LENDING-ORIENTED ASSET COMPOSITION TEST

The U.S. League is skeptical about using the commercial lending activity benchmark proposed in S. 2181 as a basis for retention of the differences that traditionally have been extended savings institutions to buttress their housing specialization. While the test certainly would assure the vast majority of savings institutions that they would qualify now and for years to come as qualified thrift lenders, it does not focus on the feature -- housing commitment -- that we believe distinguishes our institutions from commercial banks and justifies a degree of differential regulation. We note that some 10,000 commercial banks, with assets of about $600 billion, currently have portfolios that could pass muster under the commercial prong of this S. 2181 standard, and strongly question its appropriateness as a device for differentiating for regulatory purposes between banks and savings institutions.

CHANGES NEEDED IN S. 2181 HOUSING-BASED ASSET COMPOSITION TEST

By contrast, the 60 percent housing-based test contained in S. 2181 appears generally well-suited as a regulatory boundary marker between commercial banking and the savings institution industry -- provided that several vital modifications are made.

INCLUSION OF LIQUIDITY ITEMS VITAL

First, no provision is made for including liquidity items within the 60 percent basket. We consider this a mistake. Day-to-day operation of a depository institution demands that a proportion of its assets be kept in cash and items that can be readily liquidated for cash, and Federal Home Loan Bank members, pursuant to section 5A of the Federal Home Loan Bank Act, are required to maintain in liquid assets an amount equal to at least 5.5 percent of their net withdrawable accounts. Largely due to the difficult and unsettling conditions confronting our industry since 1981, many savings institutions are maintaining liquidity of at least 10 percent in the current economic environment. It is not uncommon for institutions, particularly those that have adopted a mortgage banking mode, to have liquidity of 25 percent or more at some points in the calendar. Maintenance by a savings institution of a portion of its investments in liquid assets thus is not a luxury or diversion from its housing mission, but a prudential measure central to its continued ability to deliver mortgage credit -- particularly with respect to its continued eligibility for the housing support flowing from Federal Home Loan Bank System membership. The authors of S.2181 recognized that "property used by an institution in the conduct of its business" is a necessary ingredient in the 60% test. Similarly, liquid assets used in the conduct of a savings institution's business should qualify. Accordingly, we regard inclusion of liquid assets among those items eligible to be counted toward the 60 percent basket as appropriate and essential.

We are aware that the lack of provision for liquidity in S. 2181 derives significantly from fear that institutions could invest so heavily in short-term liquid securities that they, in effect, could operate as a "money market fund" -- albeit a taxable one -- thus retaining the advantages associated with being a qualified thrift lender without devoting any resources to housing. There are a number of obstacles to such conduct. From an economic standpoint the spread realizable from a strategy of arbitraging market-rate deposits against liquidity securities would be far too low to tempt established institutions, given the level of their expense ratios. (Indeed, today's Money Market Deposit Accounts at our institutions are often priced at rates above an index based on Treasury bills of comparable maturity.) Moreover, any savings institution that attempted to restructure itself as a sort of investment company insured by the Federal Savings and Loan Insurance Corporation would run into substantial statutory obstacles. For example, section 5(a) of the Home Owners' Loan Act mandates that federal associations provide credit for homes and other goods and services in addition to serving as locations for the deposit or investment of funds. Furthermore, section 6(i) of the Federal Home Loan Bank Act makes membership contingent upon maintaining a management or home financing character consistent with sound and economical home financing, and section 403(c) of the National Housing Act likewise makes the existence of sound and economical home financing a touchstone for the granting of FSLIC insurance of accounts.

Nevertheless, we can understand the concerns expressed in this area, and suggest that one means of alleviating them without compromising necessary savings institution operational considerations would be to place a limit on the ability of an institution to count liquid assets toward the 60 percent test. For instance, liquid assets representing up to 25 percent of an institution's total assets could be credited toward satisfaction of the asset test, with excess amounts not falling within the category of qualifying assets. This would give savings institutions reasonable room to maneuver, while clearly avoiding the possibility of investment-company-style behavior.

ACCOMMODATION OF SECONDARY MARKET PARTICIPANTS ESSENTIAL

Beyond the liquidity question, the League urges as a second matter that the S. 2181 test be modified to recognize the contribution of savings institutions that originate mortgage loans and sell them in the secondary market while retaining monthly-payment servicing. As noted previously, institutions that operate in the mortgage banking mode are strong supporters of housing, and it would be inequitable to penalize such organizations by denying them the benefits accorded qualified thrift lenders which hold loans in portfolios. Both operating styles contribute to home ownership opportunities. We would be pleased to work with the staff of the Committee to develop language that would address this problem.

INCLUSION OF CHURCH LOANS AND EDUCATION LOANS IMPORTANT

The final modification we seek in the test is the inclusion of church loans and education loans, which, as mentioned earlier, already are counted as qualifying assets for the purposes of the tax code's section 7701(a)(19)(C) test. Although these investments are not made for the purpose of financing housing (except where a parish house or similar facility is part of a church structure financed, or to the extent an education loan covers room expenses) they nevertheless have been adjudged over the years to be sufficiently imbued with a public purpose to justify contributing toward the triggering of housing-related tax benefits, and we believe it would be appropriate to allow them to be used for asset test purposes, as well.

TRANSITIONAL PROVISIONS FOR SAVINGS BANKS REQUIRED

As I mentioned earlier, any asset test should make special provision to acknowledge today's investment portfolio situation at savings banks. Specifically, we suggest that institutions originally chartered as savings banks years ago be permitted initially to be treated as qualified thrift lenders at a 40 percent qualifying asset level rather than the 60 percent threshold otherwise applicable. This would recognize the fact that, although most savings banks share the strong housing commitment distinguishing savings institutions from other depositories, they historically have committed resources to other forms of long-term financing, as well, and thus have a somewhat different portfolio structure. The standard could be raised to 60 percent over a 20-year period as a means of avoiding permanent regulatory distortion.

Of course, the required nature and percentage of this transitional arrangement would depend on the detailed provisions of the asset composition test. It is important to ensure that the parity achieved by the Garn-St Germain Act in providing a unified savings bank charter is not unduly distorted by any provision made to help established savings banks adjust to the new statutory requirements.

The special transitional treatment we are urging, of course, would apply only to those institutions that originated as state-chartered savings banks. No such assistance need be afforded institutions resulting from recent conversions of federal savings and loan associations or de novo grants of charters under Garn-St Germain Act authority.

AVERAGING ADJUSTMENTS APPROPRIATE

The final technical matter I wish to comment upon with respect to the S. 2181 asset test is its use of averaging in determining compliance. We regard an averaging approach as necessary and appropriate to avoid abuses while assuring that temporary excessive investment levels caused by uncontrollable market situations need not necessarily generate permanent holding company or service corporation consequences. The three out of every four quarter standard strikes us as reasonable, but we would prefer a more flexible three out of every five year approach to the two out of every three year method proposed in the bill.

NEED FOR CHANGES IN S. 2134 ASSET COMPOSITION TEST

Turning to S. 2134, that measure would use an asset composition test as a device to limit unitary S&L holding company activities. In the event a savings institution failed to devote 60 percent or more of its assets to residential mortgages or related investments on average during any year, its holding company would be limited thereafter to those activities permissible for multiple SLHCs, Related investments would be defined as (1) securities backed by residential mortgages, (2) retail mobile home loans, (3) home improvement loans, (4) loans to finance the construction of residential properties, and (5) investment in service corporations, proportionate to the subsidiary's investment in residential mortgages or related investments. The explanation accompanying the bill seems to indicate that the term "residential mortgages" as used in S. 2134 equates to one-to-four family mortgages.

The S. 2134 asset test is substantially more restrictive in terms of the housing-related investments that could be put in the 60 percent basket. In our view, its current make-up simply is too inflexible. It would penalize use of Garn-St Germain Act authorities granted just a year-and-a-half ago. In addition, the language prohibiting cross-marketing of products and services among affiliates would be very difficult to administer. The S.2134 test also lacks the liquidity items which are a necessary part of conducting business as a savings institution. (I should note, however, that S.2134 does have a useful concept of counting a portion of service corporation investment towards the 60% standard when the service corporation's activities are devoted to otherwise-eligible investments.)

Overall, the qualifying test found in S.2134 is overly restrictive even for its stated purpose.

U.S. LEAGUE SUPPORTS USE OF ASSET COMPOSITION TEST TO MARK GENERAL REGULATORY BOUNDARY BETWEEN BANKS AND SAVINGS INSTITUTIONS

Our final suggestion relative to the asset compositon test topic is that the test should be applied in a more comprehensive context than that proposed in either S. 2181 and S. 2134. We envision an approach, such as has been discussed in connection with the recommendations of the Vice President's Task Group on the Regulation of Financial Services, whereby an asset composition test would serve as a general point of demarcation between savings institution and commercial banks, with institutions able to transfer from one mode to the other with relative ease. Under this framework, an organization that had a commercial bank charter, but was primarily a housing lender, would be regulated as a savings institution as long as it maintained an appropriate asset composition, and would be entitled, for instance, to FHLBank membership and access to FHLBank advances. A reverse migration, of course, would be required for a savings institution that abandoned its housing specialization.

Obviously, many details would have to be worked out in effectuating such a system, but we believe the drafting challenge could be met without undue difficulty.

In terms of equity and efficiency, such a system would offer important advantages. Commercial banks with a strong home mortgage orientation could enjoy the housing support mechanism offered by the FHLBank system as well as the holding company and other flexibility available to savings institutions in connection with their residential real estate function. Conversely, savings institutions that effectively abandoned housing for other investment opportunities would be afforded full commercial bank powers and subjected to regulation appropriate to such institutions. In either case, the regulatory framework would track accurately the actual activities of depositories, and afford their boards of directors and management with full freedom to choose their business direction for providing financial services to their local community.

Apart from the core question of the proper formulation and use of an asset composition test, S. 2181 and S. 2134 raise a number of other important issues that I would like to address.

SERVICE CORPORATIONS UNDER S. 2181

Based on our best reading of the literal language of S. 2181, that bill basically would have the following service corporation impact:

1. Qualified-thrift-lender federal associations could retain existing authority under section 5(c)(4)(B) of the Home Owners' Loan Act;
2. Non-qualifying federals could conduct only such activities through their section 5(c)(4)(B) service corporations as those subsidiaries were engaged in as of July 1, 1983, and have been engaged in continuously since that time;
3. All mutual savings institutions, state or federal, qualified thrift lender or otherwise, could invest up to 3 percent of their assets in "mutual thrift service corporations" which essentially would have the same authority as section 5(c)(4)(B) subsidiaries; and

4. All federal or state depositories, except qualified thrift lenders, could invest the lesser of 5 percent of their assets or 10 percent of their capital and surplus in "depository institution service corporations" (DISCs) which provide clerical-type services for other depositories -- without sacrificing any additional state or federal investment authority.

Let me stress that we are pleased that S. 2181 does not reflect the hostility and lack of understanding displayed toward service corporations by S. 1609, the Financial Institutions Deregulation Act. Service corporations have been a very useful source of investment flexibility for our institutions, and have provided extremely important earnings support in recent years -- support that was especially needed during the grim 1981-1982 period. We would oppose legislation that attempted to deprive our industry of this source of strength.

Assuming the asset test ultimately employed in S. 2181 incorporates our suggestions, we support the S. 2181 service corporation approach, subject to certain modifications. First, and of very great importance, we believe the mutual thrift service corporation concept needs to be preserved and adapted to the competitive environment that mutual associations would confront if bank holding companies receive enhanced authority. The grant of power contemplated for bank holding companies under the bill would place the vast bulk of mutuals at a significant competitive disadvantage regarding insurance underwriting, real estate brokerage and a variety of securities activities --- areas where direct or indirect federal association authority, and that available to most state-chartered institutions, appears nonexistent or very limited. In the event bank holding companies receive new powers, the U.S. League regards it as essential that mutuals be provided with additional service corporation authority to permit them to compete on a more equitable basis.

Let me be very clear on one point: the ability to convert to stock, from a savings and loan holding company and compete through holding company affiliates offers only an illusory means of dealing with this competitive challenge. Far too many savings institutions are mutual in form, far too many are too small to attract stock investor interest, and far too many are suffering from depleted net worth as a result of the 1981-1982 experience, for substantial conversion of the industry to stock to be a realistic possibility in any kind of reasonable time-frame. Mutuality inevitably will be a dominant feature in our industry's landscape for many years.

The idea of a mutual thrift service corporation, as a separate authority for mutuals only, represents an excellent avenue for resolving this situation. We suggest that the bill be modified to designate special service corporations as vehicles for competition in any new areas opened up for bank holding companies that are not currently available to federal associations or, in the case of state association service corporations, not permitted for the latter under state law. Should an institution with a mutual thrift service corporation convert to stock, provision could be made for a gradual, non-disruptive phase-out of the special service corporation's activities, either through complete divestiture or removal to the holding company affiliate level.

We realize that suggestions have been made that "mutual holding companies" should be created to take care of the mutual competitiveness issue raised by new bank holding company powers. This, it is argued, is desirable in that the capital requirements for such activities would have to be met on the open market rather than through capital infused by the depository parent, thus allowing more parity of competition. The practical obstacles to creating a mutual holding company affiliate capable of accessing the capital markets appear to us to be overwhelming, however, and the schemes with which we are familiar all involve the possibility of a large capital contribution from the savings institution to the affiliate.

In our opinion, if a capital contribution is to be permissible, it would be preferable for Congress simply to stipulate that investment in a mutual thrift service corporation would be limited to some finite amount, and structure the parent-subsidiary relationship to permit direct capital market access by the subsidiary for any expansion capital. This would simulate the mutual holding company situation in terms of capital, avoid the regulatory and other complications involved with setting up a new species of holding company, and make it somewhat easier for the savings institution to realize a return on its contributed capital.

Beyond the issue of competitive parity with bank holding companies, we believe as a second matter that the general section 5(c)(4)(B) service corporation investment basket for federals should be expanded from 3 percent to 5 percent. The 3 percent figure is outdated, and does not provide institutions with sufficient opportunity to realize the advantages offered by service corporation operations. (Five percent, incidentally, was chosen under Garn-St Germain as the investment limitation for the expanded commercial bank service corporation powers authorized by that law.)

As a third concern, the League regards the July 1, 1983 grandfathering date in the bill as unnecessary and unfair. There is no record of service corporation abuse that justifies such a retroactive approach. It is not equitable to place institutions' investment decisions in peril in this manner absent some overriding public policy consideration -- which we fail to detect in this case. We strongly suggest that grandfathering be done on a day-of-enactment basis. Moreover, we object to the "continuously engaged-in" requirement for grandfathered rights, particularly if applied in the context of inherently "stop-and-start" activities such as real estate development.

Fourth, and on a more fundamental level, we question the need to limit service corporation activities of non-qualified-thrift-lender federals in light of the subsidiary investment options open to other depositories. For instance, national banks, with their galaxy of operating subsidiaries, Edge Act Corporations, agricultural credit corporations and so on, have, in our view, an ability to invest at the subsidiary level that considerably exceeds in significance that open to federal associations -- and this flexibility for banks would not be diminished by S.2181. We thus fail to see the equity in limiting non-qualified-thrift-lender federal service corporation authority as proposed in the bill.

Finally, we do not understand why S. 2181 prevents qualified thrift lenders, both federally- and State-chartered, from investing in Depository Institution Service Corporations. DISCs could prove to be a useful investment tool for some of our members, although they probably would not be very significant industry-wide because of their specialized, largely clerical, purposes. We think it would be appropriate to extend the DISC option to all savings institutions.

SERVICE CORPORATIONS UNDER S. 2134

As we read S. 2134, its primary impact in the service corporation area, apart from the "in-tandem" cross-marketing restrictions it would impose in the holding company context discussed later, would occur in connection with the securities activities of such subsidiaries. Subsidiaries of all depositories would be covered by the same prohibitions on issuing, underwriting, selling or distributing stocks, bonds, notes or other securities as now apply to their parents. Although it is not so stated in the bill's explanation, we are very apprehensive, given the unsettled state of case law in this area, that its intent may be to eliminate general discount brokerage activities by subsidiaries of depositories and not just to forestall the full-service securities possibilities arguably available to subsidiaries of State-chartered banks which are not members of the Federal Reserve System.

While we have some sympathy with concerns over full-service involvement in the securities area by subsidiaries of depository institutions, we do not support eliminating the limited order-taking stock brokerage services currently offered by savings institutions and other depositories through subsidiaries. No abuses have arised from this brokerage authority, to our knowledge, and it appears to offer customers an attractive and valuable service. We strongly suggest the bill be modified to preserve explicitly the ability of depositories to continue to conduct order-taking brokerage business at the subsidiary level.

MULTIPLE SAVINGS AND LOAN HOLDING COMPANY ACTIVITIES

Although S. 2181 would provide bank and multiple S&L holding companies with a variety of new activities powers, it would cut back sharply on involvement by multiples in real estate investment and development. Real estate investment and development would be limited to 5 percent of primary holding company capital (which we understand would include the capital of the holding company plus the depository) and could not include any form of construction activity.

We strongly object to this feature of the bill. The 5 percent-of-capital cap is completely unrealistic, as is the bill's approach to grandfathering, which evidently would extend only to specific projects, and would have an unfair and burdensome retroactive effective date of July 1, 1983. For practical purposes, the bill would eliminate real estate investment and development as economically significant areas of endeavor for most multiple savings and loan holding firms.

Savings institutions which are part of multiple holding companies have acquired considerable knowledge and experience in real estate investment and development -- including construction -- and we fail to see the basis for this drastic proposal. Certainly, involvement in real estate is attended by certain risks, but, in our view, these risks are no less remarkable than those connected with other activities, such as revenue bond underwriting or foreign lending, for which no specific restrictions are being proposed. We believe it would be an illogical and retrograde step to deny multiple savings and loan holding companies the ability to utilize two of our industry's major areas of expertise. Another aspect of S. 1821 that we oppose is its selection of the Federal Reserve Board, rather than the Federal Home Loan Bank Board, to be the arbiter (although the Bank Board would have veto power) of new activities for multiples. The Bank Board has done an excellent job of regulating the savings institution industry over the years, largely due to is comprehensive grant of regulatory authority. Erosion of the Bank Board's power, in our opinion would be highly counter-productive.

CONSUMER BANKS

S. 2181 and S. 2134 would deal with the non-bank bank phenomenon in different ways. Essentially, S. 2134 would eliminate it, apart from grandfathered companies, while S. 2181 would sanction and regulate it.

Under S. 2181, "consumer banks" could escape Bank Holding Company Act restrictions by limiting commercial lending to not more than 5 percent of assets and restricting its scope to inventory loans, small business loans, and similar loans. Commercial lending would be defined to exclude such things as investment in commercial paper or corporate debt. However, these insured deposit-taking entities would be permitted unlimited real estate, consumer loan, credit card, and money market investments.

The U.S. League is opposed to the S. 2181 approach to resolving the non-bank bank issue. We believe that the benefit of unlimited holding company activities restrictions should not be extended to depositories unless it would further some extremely important public policy objective. While we are confident in regarding housing finance as such an objective, given the tremendous importance Congress has attached over the years to providing decent housing to the people of our nation, we are skeptical that money market instruments and consumer credit legitimately fall into such a category. Accordingly, we are not convinced that it is appropriate for a new type of federally-insured bank charter, vested with special privileges, to be invented at this time.

Moreover, we note that the consumer bank provisions of S.2181 contain no affirmative safeguards to ensure that consumer banks actually would concentrate on consumer credit.

To reiterate, we believe the consumer bank approach lacks merit and should not be permitted to go forward. On the whole, we believe S. 2134 represents a better approach to non-bank banks than does S. 2181.

ACQUISITIONS OF DEPOSITORIES BY INVESTMENT BANKING COMPANIES

For some time now, the U.S. League has been extremely concerned about the possibility of affiliation between securities firms, especially investment banking companies, and savings institutions or other depositories. While such connections are not possible in the case of securities firms and commercial banks, there is no explicit statutory obstacle in the case of savings institutions or non-bank banks. Permitting a proliferation of such affiliations would be a serious mistake, in our opinion, for they would be inimical to the maintenance of the savings institution or other depository subsidiaries as entities with community orientation, and would undermine the ability of the Federal deposit insurance agencies to manage their risk exposure.

S. 2134 would address this situation with respect to non bank banks by the simple expedient of prohibiting further creation of such organizations. S. 2181 would not erect any barriers to securities firm takeovers of consumer banks, however, and neither bill explicitly would prevent securities firms from exploiting unitary savings and loan holding company flexibility to purchase savings institutions. We strongly urge that any legislation developed following these hearings be amended to forestall securities firms -- particularly those engaged in investment banking and corporate securities underwriting -- from acquiring depository institution subsidiaries.

Our view is that the dominant motive of a securities firm in seeking a savings institution or other depository subsidiary would be essentially to secure a device to provide FSLIC or FDIC insurance for the investment products offered to the parent company's Wall Street customers. Depository institutions playing such a role would be unlikely to continue as community-oriented credit suppliers, to the detriment of local housing, consumer, and small business needs.

We are concerned that using depository institution subsidiaries to obtain de facto federal protection for securities products could generate an unacceptable increase in the risk exposure of the FSLIC and FDIC insurance funds.

S. 2134 RESTRICTIONS ON AUTHORITY OF STATE INSTITUTIONS

One aspect of S. 2134 that we oppose vigorously is its restrictive approach to new activities by state-chartered institutions. After June 3, 1983, activities could not be commenced unless they were authorized explicitly under state law by a statute adopted (or an interpretation promulgated thereunder) prior to January 1, 1983, permitted for bank holding companies or federal savings associations, or performed exclusively in-state for in-state residents.

While the U.S. League can understand Congressional concern over the aggressive approach some states have taken to providing new empowerments to their financial institutions, we do not feel that any real basis exists for the sweeping restrictions proposed. A particular concern is the back-dating of the prohibition to laws adopted after December 31, 1982. On the whole, we are convinced that our dual regulatory system has served us well over the years in providing important innovations -- such as NOW accounts. The U.S. League is convinced that whatever problems currently exist in this area can be remedied by appropriate regulatory action.

BANK HOLDING COMPANY ACT COVERAGE OF NON-FSLIC-INSURED SAVINGS INSTITUTIONS

Although the Garn-St Germain Act amended the Bank Holding Company Act to prevent federal associations or FSLIC-insured institutions from being defined as banks for Bank Holding Company Act purposes, no such protection was provided other savings institutions. Accordingly, the recent Federal Reserve Board broadening of the definition of commercial loan and demand deposit and consequent expansion of the universe of institutions actually or potentially subject to the Bank Holding Company Act restrictions has been a source of concern for that section of the savings institution industry that has neither federal charters nor FSLIC insurance. This concern is not limited to holding companies or stockholder-owned associations: interest is widespread among mutuals which are contemplating conversion to stock as part of their efforts to rebuild net worth.

The U.S. League does not believe it is necessary or appropriate to require state-chartered, non-FSLIC-insured savings institutions that are in holding company organizations to observe narrow Bank Holding Company Act requirements, as implemented by the Federal Reserve's Regulation Y. These institutions have elected not to choose the federal deposit insurance route in order to preserve opportunities under local law; yet, they continue to comply with the home-lending specialization dictated by the federal tax laws and are considered to be in the family of savings institutions. This, in our view, is a legitimate business decision, and one that poses little if any danger to our national financial system, given the existence of healthy depositor-insurance funds.

We see no basis in sound public policy for deciding that the holding companies of such institutions should be forced to adhere to disruptive Regulation Y standards. Apart from requiring insurance and real estate investment and development activities to be divested, Reg Y would compel depository subsidiaries of such holding companies to obtain FDIC insurance within two years -- a task which, from a statutory standpoint, may be impossible for many non-federally-insured savings institutions.

The U.S. League therefore suggests that the Congress afford all savings institutions the Bank Holding Company Act exemption now available only to those that are chartered by the FHLBB or insured by the FSLIC, thus leaving holding company issues affecting state-chartered, non-FSLIC-insured entities entirely to state regulation. Should some federal-level holding company regulation be deemed necessary, we urge that jurisdiction be given to the FHLBB, the primary federal regulator of our industry, rather than the Federal Reserve. Such regulation, of course, necessarily should allow unitary savings institution holding company flexibility to be extended to parents of state-chartered, non-FSLIC-insured institutions on the same basis afforded to other unitaries.

ANTI-TYING PROVISION

S. 2181 would allow trade associations to bring suit on behalf of their members to enjoin violations of the anti-tying restrictions that were made applicable to federal associations by the Garn-St Germain Act. These restrictions, which we opposed at the time as unnecessary and duplicative of existing regulations, and continue to find highly objectionable, were designed to prevent customers of financial institutions from being forced to purchase unwanted services in order to obtain the services desired. The current proposal would simply increase the possibility of litigation in this area, a prospect that hardly strikes us as consistent with the public interest. We are unaware of any record of abuses in this area that merit the extraordinary step of permitting trade association participation in suits for injunctive relief under these provisions, and suggest that public policy would best be served by striking this provision from the bill. We note, moreover, that S. 2181 would make no provision for providing the FHLBB with authority, such as the Federal Reserve already possesses with respect to commercial banks, that would allow the Bank Board to fashion exceptions to the coverage of the anti-tying provisions. The U.S. League urges that this omission be rectified.

S. 2134 RESTRICTIONS ON "IN-TANDEM" OPERATIONS OF SAVINGS AND LOAN HOLDING COMPANIES

Under S. 2134, enjoyment of unitary SLHC flexibility would depend, not simply on the passing of a 60% asset composition test by the subsidiary savings institution, but on the lack of any cross-marketing of products or services among holding company subsidiaries and affiliates. Specifically, the subsidiary insured institution's products or services could not be offered to or marketed through the holding company or its other subsidiaries, and the products or services of the holding company or its subsidiaries could not be marketed through or offered to the subsidiary insured institution. As a practical matter, this would require, from a transactional standpoint, an almost complete isolation of the various units of a holding company from one another as the price for securing activities flexibility.

The U.S. League has serious concerns about the competitive and other problems resulting from the cross-marketing of financial services by holding companies, and thus is sympathetic to the impulse behind this aspect of the bill. As presently constructed, however, the provisions are far too sweeping. For instance, it appears that service corporations would be unable to secure credit from their parents and that holding companies would be unable to sell management services to their subsidiaries -- results which seem to us unjustifiable. We would be interested in reconsidering this part of the bill if its scope could be narrowed greatly and its focus substantially sharpened.

RESTRICTIONS ON ACQUISITIONS BY LARGE SAVINGS AND LOAN HOLDING COMPANIES

S. 2181 would impose special restrictions on the ability of bank and savings and loan holding companies with very large depository subsidiaries to engage in certain activities, including insurance underwriting or brokerage, real estate investment, development or brokerage, securities activities, and ownership of a bank, and on the ability of companies that engage in such activities to acquire very large savings institutions. The objective is to prevent depository holding companies controlling 0.3 percent or more of total domestic deposits from having, as a result of an acquisition, more than 25 percent of their capital invested in any one such activity.

Apparently it is felt that such unions would represent excessive amalgamations of economic power.

While the U.S. League is very sensitive to the danger of concentration of resources in our economy, we are not convinced, given the extent of available antitrust authority, that an adequate case has yet been made that the proposed restrictions are necessary. We intend, however, to follow discussion of the issue closely during these hearings.

TRANSACTIONS WITH AFFILIATES

S. 2181, in order to provide more equality of treatment with respect to the ability of bank and savings and loan holding companies to engage in insurance, real estate brokerage and securities activities, would require the depository institution subsidiaries of such organizations to observe identical transactions-with-affiliates restrictions with respect to those activities. On balance, the applicable restrictions, which would be found at sections 23A and 23B of the Federal Reserve Act, would provide S&L holding companies with a more liberal regime than they now experience. We regard such parity as a positive step, and support this provision of the bill.

S. 2181 UNITARY SAVINGS AND LOAN HOLDING COMPANY GRANDFATHERING

Regarding unitary S&L holding firms with savings institution subsidiaries unable to qualify as thrift lenders, S. 2181 would grandfather those activities the holding company was engaged in as of July 1, 1983, and had engaged in continuously therafter. As we have noted previously, we regard use of a retroactive grandfathering date, rather than the date of enactment, as oppressive and unnecessary. Unitary S&L holding company activities are already tied to an asset composition test, enacted barely over a year ago, and we believe that test is more than adequate to prevent any abusive behavior from occurring during the consideration of the current legislation. A retroactive effective date thus seems unjustified. It is substantially unfair, however, in that it has injected a growing note of uncertainty into the planning processes of institutions.

INTERSTATE COMPACTS

S.2181 would empower states to authorize their banks and savings institutions to participate in regional branching compacts. The wording of the provision, however, is such that it could cause confusion regarding the authority of federally-chartered savings institutions in this area, which was clearly set forth in the Garn-St Germain Act. Given the fact that the Act already empowers federal associations to participate in such compacts, and that no underlying Constitutional question exists for federals, we strongly urge that all mention of such institutions be deleted from this section of S. 2181. In addition, we note that the inter-agency study group that would be formed under this part of the bill would not include the FHLBB, a considerable oversight given its responsibilities, and one that we urge you to correct. The general subject of interstate expansion by depositories is complex and provocative. Perhaps the Committee might wish to consider this Title of S.2181 as separate legislation.

CHANGES IN DEMAND DEPOSIT AUTHORITY

S. 2181 would eliminate the longstanding ban on paying interest on demand deposits, thus opening the door to interest-bearing corporate checking accounts. In addition, it would allow not-for-profit political organizations to have NOW accounts. We wholeheartedly support these initiatives. If rate ceilings were inappropriate for other categories of accounts, a no-interest policy likewise is unjustifiable for demand deposits, and should be eliminated.

In addition, we would urge your Committee to remove the eligibility barriers remaining in federal law to full participation by savings institutions in providing demand accounts for individuals and all corporate customers. The current requirement that a "loan relationship" must exist for a federal savings association to offer a checking account to a business customer only interferes with our efforts to serve the communities in which we operate. It prevents full depositor service, for example, to realtors and others in the housing chain, which might to wish to maintain a full-service relationship with our housing specialized depositories. And despite the universal spread of NOW accounts, there is no justification for continuing to deny ordinary checking account services to individuals who choose to maintain their transaction-account relationships with savings institutions.

The U.S. League marvels at testimony received from other witnesses at these hearings that removal of these last vestiges of deposit regulation will somehow imperil the financial system. Many of these prophets are the same groups which so fervently advocated savings-deposit deregulation -- a Congressional decision which impacted virtually all of the funds-acquisition methods open to savings institutions. The fact is that these opponents of checking account deregulation merely wish to preserve a little longer a lucrative enclave of protectionism under which the commercial banking industry has profited from interest-free demand deposits for many years.

Our League also rejects the claim that somehow checking account services at savings institutions will wipe out instantly any remaining distinctions between specialized thrift institutions and their commercial banking competitors. The housing-related asset composition test of S.2181 demonstrates a fundamental recognition that savings institutions have historically, and will continue to have, a specialized role in our financial system based on their investment activity.

As a final comment, we see no reason for the minimum six-month delayed effective date proposed for the onset of decontrol in this area. Demand accounts should be made subject to the rate decontrol process immediately. Furthermore, we question the bill's extension of authority to the Depository Institutions Deregulation Committee to delay implementation for a further six months. We see no need whatsoever for the DIDC to be afforded any special period of time for the implementation of this provision, given the fact that the bill specifies that the rates on demand accounts -- the key regulatory issue -- would be identical to those on NOW accounts.

INTEREST ON RESERVES

The U.S. League supports the provision in S. 2181 requiring the Federal Reserve to pay interest on reserves held against certain transaction accounts, including money market deposit accounts. This step would be very helpful in assisting savings institutions to compete with money market mutual funds, which do not have to maintain reserves with the Federal Reserve, and thus have an important cost edge over depositories. Allowing our institutions to earn interest on reserve balances would reduce this advantage, and allow them to be more effective competitors.

STATE USURY LAW PREEMPTION

S. 2181 would restore, in more detailed form, the federal preemption of state usury laws affecting business and agricultural loans (previous authority had lapsed on April 1, 1983) and establish a new federal usury preemption for consumer loans. This is another provision that the U.S. League supports enthusiastically. Usury restrictions have inflicted serious damage on parts of our nation's financial system over the last twenty years, while completely failing to generate any offsetting benefits for the consuming public. The language permitting States to reassert their authority within three years is a reasonable balancing of State's rights and the federal interest in our dual system of financial chartering, regulation and services.

REQUIREMENTS ON CHECK HOLDING

S. 2181 incorporates S. 573, the Fair Deposit Availability Act. The views of the U.S. League on that bill were transmitted to Senator Hawkins in a letter dated September 25, 1983. We have attached a copy of that letter as Exhibit A.

NEED FOR A SPECIAL-PURPOSE, MORTGAGE-SECURITIES SUBSIDIARY

Mr. Chairman, before concluding I would ask your indulgence to raise one additional issue because the subject-matter falls clearly within the jurisdiction of this distinguished Committee.

Last fall, this Committee processed, and the Senate subsequently passed, S.2040, the Secondary Mortgage Market Enhancement Act. The original version of that legislation (S.1821) included a specific provision authorizing national banks to underwrite and deal-in securities backed by conventional residential loans. It was our understanding at the time that comparable authority would be provided for savings institutions -- if detailed legal analysis indicated that it would be necessary for our institutions to participate fully in all steps of the "securitization" process for conventional mortgages.

If the purposes of S.2040 are to be realized to their fullest, and mortgage securities encouraged, it seems logical to include the dominant and traditional source of home mortgage credit, savings institutions, as full-fledged participants.

Subsequently, when your Committee marked up S. 1821, the decision was made to defer the question of mortgage-securities underwriting and dealing by national banks to the legislative package (S.2181) under consideration this morning.

We have now examined the legal authority of savings institutions to participate fully in the emerging world of mortgage securities and have identified a fundamental deficiency. We believe that savings institutions will need new authority for special-purpose mortgage-securities subsidiaries if they are to be a part of these new ways of attracting credit for homebuyers. It is our view that this authority is required for us to utilize mortgage-securities structures known as "CMOs", or collateralized mortgage obligations, already in existence in the private sector. Certainly, the subsidiary is an essential ingredient for our participation in "TIMs", or trusts for investment in mortgages, if that legislation -- sponsored by several distinguished Members of this Committee -- goes forward in the remaining days of this 98th Congress.

Thus, we would ask your favorable consideration if a special-purpose, mortgage-subsidiary amendment is included by the House of Representatives in the companion legislation to S.2040 (H.R.4557), or if another appropriate legislative "vehicle" should develop.

Unfortunately, the approach of the Financial Services Competitive Equity Act (S.2181) in this area excludes, by definition, all but 120 or so of the nation's 4,000 savings institutions. That is because S. 2181 would authorize mortgage securities' underwriting and dealing only for affiliates of savings and loan holding companies. The vast majority of our institutions are mutual in corporate form and most of those which are stockholder-owned are not part of a holding company structure.

To deny full participation in mortgage "securitization" to such a large segment of what has been heretofore the dominant financing intermediary for home mortgages would greatly diminish the potential for achieving the "enhancement" for the homebuying public mentioned in the title of S.2040.

Legally, I should also note that it is the opinion of our counsel that authority for savings institutions to underwrite and deal-in mortgage securities is somewhat distinct from the statutory changes which might be necessary for commercial banks and their holding companies, since savings institutions are not mentioned in this context in the Banking Act of 1933

(Glass-Steagall) -- perhaps because of their insignificant role in the financial marketplace at the time that landmark legislation was enacted.

The special-purpose mortgage-finance subsidiary we advocate would provide a workable mechanism for the issuance of the newer types of mortgage-backed securities, such as the CMOs. These "structures" involve the contribution by the home mortgage originator of loans to a trustee-issuer which, in turn, with the help of an underwriter, packages and distributes the securities for sale to the public. Contributing mortgages constitutes an "investment" in the subsidiary. Under existing law (such as the Home Owners' Loan Act which governs investment by federally-chartered thrifts) there is no provision for investing in a mortgage securities issuer. The closest existing provision is authority to invest in a "service corporation" -- but, as noted elsewhere in this statement -- that authority is strictly limited to 3% of assets. In the vast majority of today's thrift institutions, at least a portion of the 3% is already committed to other activities. Mortgages contributed to a mortgage securities-issuing subsidiary could very quickly exceed the available service-corporation investment limit, particularly for smaller and neighborhood savings institutions.

A jointly-owned subsidiary mechanism could also permit these smaller and neighborhood institutions to band together to offer securitized mortgage products so that they might collectively attract the attention of the money markets and raise fresh funds for lending in their communities. And there is at least the theoretical possibility that a mortgage securities-issuing subsidiary could help "monetize" a portion of our "seasoned loan" portfolios which remain a "drag" on the ability of our institutions to restructure.

A statutory change authorizing such subsidiaries would also be helpful in obtaining bond ratings for the new securities products, since the financial health of many parent institutions (as this Committee is well aware) was severely impaired in the early years of this decade. It would also overcome questions about the "prior claims" the FSLIC might assert over parent institution assets -- uncertainties which make direct mortgage securities issuance by the parent itself difficult since they raise "call protection" doubts for institutional investors in the parent's own securities products. Potentially, this authority could make mortgage securities available over-the-counter to local investors as an alternative to "jumbo" certificates of deposit, as well. This could be particularly appropriate for large investors who wish to see their funds reinvested in the housing of their local communities.

To repeat, statutorily we believe both problems -- assuring full participation in all phases of mortgage-delivery and overcoming the investment limitations of current law -- could be solved through creation of special-purpose mortgage-securities subsidiaries at federally-chartered and federally-insured savings institutions. Such authority would permit thrifts to set up wholly-owned, or join together to form, subsidiaries engaged solely in the business of issuing, sponsoring, servicing, holding, underwriting, or dealing-in mortgage-related securities, as defined in Section 102 of S.2040.

Some minor amendments might also be appropriate in certain sections of the law governing the operation of savings institution holding companies, Section 408(d) of the National Housing Act. Full utilization of mortgage securities powers through subsidiaries may require exceptions to certain inter-affiliate transactional prohibitions now found in that Act.

The recommendations I have just made should be incorporated in any secondary market enhancement legislation eventually cleared by the Congress to ensure that savings institutions are not seriously disadvantaged in the changing world of mortgage finance. Without these additions, the changes made by S.2040 would not do as much as they could to broaden the pool of mortgage credit and could, indeed, be counterproductive by relegating specialized thrift institutions to second-class status in the mortgage-delivery processes of the future.

CONCLUSION

To conclude my remarks very briefly, Mr. Chairman, let me stress that, from the perspective of the U.S. League, the key feature of the bills before the Committee is the asset composition test. It is essential that we have such a test in place to allow our institutions, consistent with the intent of the Garn-St Germain Act, to make reasonable, unpenalized use of their new powers as a means of strengthening their role as residential real estate lenders. While the current S. 2181 test is clearly superior to that contained in S. 2134, both are definitely in need of modification -- particularly in the all-important liquidity and mortgage banking areas. A properly crafted standard could prove invaluable as a device for establishing a logical line of demarcation between the savings institution and commercial banking industries and for providing institutions with a greater degree of choice in determining their own location in the financial landscape.

Regarding another major thrust of S. 2181, if important new powers are provided to bank holding companies, we feel strongly that mutual institutions must be given comparable authority at the subsidiary level to enable them to compete effectively.

Looking at another part of the bill, we agree that it is time to complete the deposit deregulation process by removing the long-standing prohibition of payment of interest on demand deposits. At the same time, the Congress should remove the remaining eligibility barriers which prevent savings institutions from fully serving the public in this deposit area.

I have also explained at some length why we believe a special-purpose, mortgage-finance subsidiary is needed -- as an amendment to separate legislation.

Mr. Chairman, we deeply appreciate this opportunity to testify. If you have any questions concerning our statement, I will be happy to try and answer them.

Thank you.

Exhibit A

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ROY G. GREEN
Executive Vice President

September 25, 1983

The Honorable Paula Hawkins
Chairwoman, Subcommittee on
Consumer Affairs
Banking, Housing and Urban
Affairs Committee
313 Hart Senate Office Building
Washington, D. C .20510

Dear Senator Hawkins:

The U. S. League of Savings Institutions* welcomes this opportunity to present its views with respect to S.573, The Fair Deposit Availability Act. We believe that deposit hold policies are necessary to prevent excessive loss to financial institutions offering NOW accounts, demand accounts and other deposit accounts. Moreover, our analysis shows that under the current deposit hold system few customers are denied access to funds because of deposit holds. Very few customers' checks are returned because they draw on funds still subject to a deposit hold.

Ultimately, the solution to any concern consumers may have regarding delayed access to deposited funds is to eliminate, as much as possible, the need for the customer to physically deposit checks to his account. This can be accomplished if customers are able and willing to have checks of all types -- payroll, government, dividend, etc. -- deposited electronically to their accounts. Such funds would be immediately available. However, the availability and consumer acceptance of electronic direct deposit in the United States currently lags far behind that of other industrialized nations.

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* The U. S. League of Savings Institutions, formerly the U. S. League of Savings Associations, has a membership of 3,500 companies representing over 99% of the assets of the $730 billion savings and loan business. League membership includes all types of associations -- Federal and state-chartered, stock and mutual. Recently, many prominent savings banks have joined the League as members. The principal officers are: Leonard Shane, Chairman, Huntington Beach, California; Paul Prior, Vice Chairman, New Castle, Indiana; William O'Connell, President, Chicago, Illinois; Stuart Davis, Legislative Chairman, Beverly Hills, California; and Roy Green, Executive Vice President, Phil Gasteyer, Legislative Counsel, Jim Freeman, Senior Legislative Representative, Washington, D. C. League headquarters are at 111 East Wacker Dr., Chicago, Illinois 60601. The Washington Office is located at 1709 New York Avenue N. W., Washington, D. C. 20006. Telephone: (202) 637-8900.

Why Savings Institutions Use Deposit Holds

Savings institutions place deposit holds on deposited checks to reduce the risk that they will incur a loss when honoring customers' checks drawn on these funds. Such a loss can occur when the institution pays out funds represented by the deposited check only to find that the check is returned unpaid by the institution on which it is drawn. If this occurs, the institution incurs a direct loss unless it is reimbursed by the customer.

Savings institutions and other financial institutions must be particularly concerned about deliberate attempts of individuals to commit fraud by the practice known as "kiting" or by depositing stolen, forged or bogus checks.

Losses can also be incurred without a customer's initial deliberate attempt to defraud an institution if the customer has withdrawn the funds represented by a deposited check and is then unable or unwilling to reimburse the financial institution when the deposited check is returned unpaid.

Savings institutions generally utilize deposit holds to focus their security procedures in areas which present the greatest risks of loss. The institution conversely, seeks to avoid inconveniencing customers by not enforcing holds when the risk of loss is minimal. The mitigating effect of such selective policies is apparent by examination of actual statistics for items returned because of drawing on held funds.

Impact of Deposit Hold Practices of Savings Institutions

Although most savings institutions place holds on checks deposited by customers, the effect is of little consequence to most customers. This is demonstrated by the finding of a recent 1982 survey conducted by the U. S. League of 67 savings institutions which supplied information with respect to their deposit hold practices concerning NOW accounts. The survey respondents represented institutions ranging in asset size from $50 million to $4 billion and operating in market areas ranging in size from small towns to very large metropolitan areas.

First, it should be emphasized that deposit holds rarely affect the interest earned on funds the customer deposits to a NOW account. Whether or not they place a hold on a deposited check, most savings associations pay interest on such funds from the date they are deposited. Moreover, the customer earns interest on these funds even though the institution may have to wait as much as a week to receive the proceeds of the check in a form which allows the institution itself to begin earning income on the funds.

Thus, the customer benefits from the savings institution practice of paying interest from date of deposit. In doing so, savings institutions, in turn, avoid the operating and customer relations problems that would occur if earnings credits were delayed until the institution itself had received investable funds from the collection of such deposited checks.

With respect to the effect of deposit holds on customer-access to funds, the survey data shows that the number of checks savings institutions return unpaid because of drawing on held funds is very low. For example, respondents to the survey reported that during January 1982 the frequency with which customer checks were returned for drawing on held funds was as follows:

	Customer Checks Returned Drawing on Held Funds per 100,000 Checks Processed		
Market Area Population	Average Number	Average Percent	Number of Respondents
Metropolitan (1,000,000+)	66	0.07%	13
Metropolitan (100,000 to 1,000,000)	26	0.03%	31
Small town and suburban	27	0.03%	14

Detailed analysis of the statistics shows that 50% of institutions serving smaller communities returned no checks because of deposit holds during the entire month of January. During this period, nearly 25% of those serving large metropolitan areas also reported not returning any checks because of deposit holds.

Clearly, the percentage of customer checks returned for drawing on held funds is very low. Furthermore, considering that approximately 1% of all customer checks are returned for all reasons, checks returned for drawing on held funds represent only about 1/20th of the total number returned. Therefore, it is evident that deposit hold policies of savings institutions have relatively little effect on the ability of customers to draw on funds deposited to NOW accounts.

Because deposit hold policies are not rigorously enforced, savings institutions do incur some losses as a result. During 1981, a period when most survey respondents first began to offer NOW accounts, institutions serving large metropolitan areas wrote off an average of approximately $0.71 per NOW account per year because of paying customer checks that drew on uncollected funds. Institutions serving metropolitan areas of less than 1,000,000 in population incurred losses averaging $0.67 per NOW account per year. Institutions serving small communities incurred considerably smaller losses. Thus, the nature of the market area has a great deal to do with the care that must be exercised in dealing with checks deposited by customers.

Generally, larger losses were associated with relatively liberal hold policies. For example, one large institution that, as a policy, did not return any items drawing on held funds, experienced a loss of more than $2.00 per NOW account during 1981 because of paying these items.

Prior to reviewing in detail deposit hold practices of savings institutions generally, it would be appropriate, at this juncture, to comment on specific provisions of the Fair Deposit Availability Act of 1983.

Current Legislation

The current version of S.573 imposes many unreasonable restraints upon depository institutions. The most onerous provision of the legislation is contained in Section 6. This Section provides:

> "Not later than 24 hours after a payor depository institution determines not to pay a check or similar instrument of $250 or more it shall directly notify the depository institution at which the check was originally deposited of such non payment."

This expedited notice requirement for items of $250 more that are returned would impose an enormous workload on financial institutions. Large check processors would be faced with literally thousands of calls each day to institutions on which the checks are drawn. Since there are more than 23,000 depository institutions which would be involved in this process, the potential impact of such a requirement is significant.

Implementation of Sectin 6 would raise the following issues: (1) Who at each institution would one call? (2) Would the institution receiving the call be willing to act on the information received by telephone? (3) Who would bear the expense of the call? We believe that this Section would impose burdensome and confusing requirements on depository institutions. This section should be eliminated from the Bill.

Section 5 provides that "each depository institution should maintain its endorsement on checks and other items described in regulations of the Board [Federal Reserve Board] in a position provided for in the endorsement standard (ANSI X-9.3-1981) or in regulations of the Board."

This requirement for compliance with the ANSI-endorsement standard is unrealistic since, to our knowledge, neither the manufacturer of the endorsement equipment nor the processors of the checks are able at this time to provide clean, clearly-legible endorsements as required by the standard. Accordingly, this requirement should be eliminated from the legislation.

Section 3 contains a series of disclosure requirements. While the U. S. League does not oppose disclosure requirements, it appears that the various financial institution regulatory agencies could encourage depository institutions to disclose deposit practices without the passage of this legislation.

However, the adoption of Section 3 does raise certain problems. It could increase the possibility of check fraud since depository institutions would be required to disclose deposit hold practices. Knowledge that an institution places, for example, a two-day hold on a particular class of checks would make the perpetration of check fraud even easier.

We do not oppose the requirement of Section 4 mandating that depository institutions may not delay computing interest on funds beyond the date on which it receives a provisional credit for the check. It should be noted, however, that we are unaware of any savings institutions which engage in the practice of delaying earnings on deposits. The marketplace competition would readily correct for any perceived problems with credited earnings. Moreover, the administrative complexity of figuring out effective deposit dates would discourage institutions from engaging in this practice.

Finally, we believe that the civil liability attached to failure to perform under this legislation is extremely severe. The penalties for non-compliance are clearly disproportionate to the nature of the violation. The failure to comply with comparable provisions of various statutes would rarely lead to problems for the public that warrant penalties as severe as those in Section 9 of the Bill. Further, it appears that the potential for lost business from the failure to provide good customer service is sufficient penalty for excessively lengthy hold practices.

Detailed Review of Deposit Hold Practices of Savings Institutions

While the effect of deposit hold policies is primarily defined by the degree to which the customer is actually denied access to funds, a summary of savings institution deposit hold policies may also be of interest to the subcommittee. A description of such policies includes how the length of deposit holds is determined, the length of hold applied to various categories of checks, adequacy of deposit holds, the exceptions made in applying holds, the percentage of deposits actually held and the policy for handling a customer check reported as drawing on held funds.

1. How the Length of Deposit Holds Is Determined

The length of a deposit hold is determined by the period of time required for the savings institution to be reasonably confident that a deposited check forwarded for collection will not be returned unpaid. This period is governed by the number of processing points in the check collection system through which a check must pass in order to be presented to the institution on which it is drawn. These are also the points through which it must pass in reverse order if the check is dishonored by the drawee institution.

As institution can estimate how long it should take for a particular class of deposited checks (e.g., checks drawn on local institutions, checks drawn on out-of-state institutions, etc.) to be presented to the drawee institution and returned to the institution if dishonored. This estimate can be made making an assumption about the probable route the item will take through the check collection system and also assuming that all institutions handling the item will observe the processing deadlines established by the Uniform Commercial Code (UCC). However, as discussed below, the actual time taken for checks to be returned is likely to exceed the theoretical clearance and return time and therefore some additional time must be allowed.

2. Length of Deposit Holds Employed by Savings Institutions

The actual number of processing points through which an item passes for collection and subsequent return is somewhat related to the distance between the savings institution where the item was deposited and the institution on which it is drawn. For this reason, savings institutions typically classify deposited checks into three groups: (1) those drawn on local institutions; (2) those drawn on institutions outside the local area but within the state; and (3) those drawn on institutions out of state. (The exact nature of the market area and check clearing patterns may make it appropriate for an institution to use a somewhat different classification.)

Most institutions designate the hold period in terms of calendar days which automatically allows for weekends when checks would normally not be processed. (In the following discussion of hold periods, institutions expressing hold periods in business days have been converted into equivalent calendar days.)

The median hold period assessed for various categories of deposited checks by savings institutions in different market areas is shown in the following table:

Length of Deposit Hold in Calendar Days of Median Institution* by type of Item and Market Area

Type of Item	Metropolitan: 1,000,000+	Metropolitan: 100,000 to 1,000,000	Small Town and Suburban
Local	4	4	4
Within state, non-local	7	7	6
Out-of-State	9	11	11

* Half of the respondents had shorter and half had longer hold periods.

As the table shows, the length of the hold period is related to the distance the item must travel to get to the institution on which it is drawn. The nature of the market area in which the institution is located appears to make little difference to the length of hold imposed for various classes of items. The one exception is that institutions in large metropolitan areas appear to use shorter holds for out-of-state items. This, perhaps, reflects the fact that such institutions have more direct access to the large correspondent banks typically involved in clearing such items.

3. Adequacy of Deposit Holds: A Case Study

As stated previously, institutions can estimate the hold period based on the probable flow of the item through the check collection system and the processing deadlines established under the UCC. In actual practice, however, the time required for the item to be presented and returned can significantly exceed this estimate.

A three-week survey of return items made by a New York savings institution showed that the number of days between the date the association forwarded the check for collection and the date the returned check was received almost always exceeded the hold period, and usually by a significant number of days.

For example, while the association uses the equivalent of a seven-day hold for items drawn on institutions in metropolitan New York, only 1% of checks returned by local institutions were received within the seven-day hold period. About 90% took at least 10 days to be returned, 54% took at least 13 days, and 10% took more than 15 days.

The association had a similar experience with items drawn on institutions outside of the metropolitan area. For these items, the association uses the equivalent of an 11-calendar-day hold. About 10% of these return items were received within 11 calendar days. About 60%, however, required at least 16 days to be returned and 10% took at least 20 days to be received.

Based on this experience, the institution could justify lengthening its hold period. To be 90% certain that a return items will be received before the hold expires, the institution would have to lengthen the hold period on local items from seven days to 15 days while the hold period on out-of-town items would have to be lengthened from 11 days to 20 days.

Informal comments of other savings institutions suggest that the experience of this institution is not unusual. What may be happening is this:

--- While large-dollar checks being returned are handled expeditiously to avoid being challenged by a claim of late return, return items for small amounts may be handled with less urgency.

--- Handling of return items is still a costly, time-consuming, manual process. Therefore, resources may first be concentrated on large-dollar items being returned and then applied to any backlog of small items remaining to be handled.

--- Participants in the check collection system seem to accept this practice as a realistic way to hold down costs while allowing the system to operate in a reasonably smooth and efficient manner.

4. Conditions Under Which Deposit Holds Are Waived

Savings institutions, as they have competed with banks for NOW account customers, have been mindful of the need to avoid antagonizing customers with unreasonable hold policies. Thus, many institutions will waive holds under certain conditions. For example, at least two-thirds of institutions will waive holds for deposits of government checks, well-recognized payroll checks and cashier's checks. A similar proportion will waive holds on deposits made by established customers. Thus, only a portion of deposits are actually subject to a hold.

5. Percentage of Deposits Actually Held

For the typical institutions, only about one-third of deposits are actually held. This reflects the effect of exemptions made for certain types of checks deposited and for established customers. But, even if deposits are held, the actual effect of the deposit hold can only be established based on what happens when a customer's check is reported as drawing on held funds.

6. Policy for Handling Checks Drawing on Hold Funds

More than 90% of survey respondents will review the situation when an item is reported as drawing on held funds. The institution will look at the number of days before the hold expires, whether the customer has other account relationships, and how the customer has handled his checking account. Unless the circumstances are unfavorable, the institution is likely to pay the item rather than return it. Less than 10% of respondents automatically return checks drawing on held funds.

Improving Customer Funds Availability Will Require Fundamental Changes in the Payments System Rather Than Changes in Deposit Hold Policy

Based on the survey data reported above, it does not appear that NOW account customers of savings institutions are being disadvantaged by deposit holds. Because savings institutions are new entrants into this market and are motivated to increase their market share, most have been careful to avoid antagonizing customers by indiscriminate enforcement of deposit holds. In any event, the hold periods which are employed may, in fact, be inadequate due to the manner in which the check collection system actually deals with return items.

Any attempt to regulate a reduction in length of deposit holds will mean that institutions will be increasingly vulnerable to losses. If institutions incur greater costs because shorter hold periods increase losses due to checks drawing on uncollected funds, these costs will be passed along to all customers, most of whom are not responsible for this increase in costs.

The one change to the payments system that will improve funds availability to consumers without increasing costs is expansion of electronic direct deposit of payroll, dividend and government checks. Such deposits represent immediately available funds to the customer since the institution gets good funds at the same time as it receives the information about the customer's deposit.

Perhaps the solution to eliminating delays in availability of customer funds is to find a way to encourage both business and consumers to accept direct deposit. If direct deposit were more widely accepted, it is possible that both cost and efficiency gains would benefit all.

Very truly yours,

Roy G. Green

Roy G. Green
Executive Vice President

ALE:tm

The CHAIRMAN. Thank you very much, Mr. Zellars, and your full statement will be included in the record, as Mr. Cooke's and Mr. Muse's as well.

Senator Mattingly, do you wish to make any comments at this point?

OPENING REMARKS OF SENATOR MATTINGLY

Senator MATTINGLY. Thank you, Mr. Chairman.

While I have no opening statement, I would nevertheless like to welcome to the Senate Banking Committee Mr. John B. Zellars and thank him for testifying before the committee today on behalf of the U.S. League of Savings Institutions. As you know, Mr. Zellars is chairman and president of Georgia Federal Savings Bank, headquartered in Atlanta. At the league's 91st annual convention this last fall, Mr. Zellars was elected vice chairman.

I welcome him to the committee and appreciate his testimony today.

Mr. ZELLARS. Thank you.

The CHAIRMAN. Mr. Cooke.

STATEMENT OF M. TODD COOKE, CHAIRMAN, PHILADELPHIA SAVINGS FUND SOCIETY; CHAIRMAN, NATIONAL COUNCIL OF SAVINGS INSTITUTIONS

Mr. COOKE. Mr. Chairman, members of the committee, my name is M. Todd Cooke. I am the chairman of the Philadelphia Savings Fund Society and chairman of the National Council of Savings Institutions.

We also have prepared a detailed written statement and appreciate the opportunity to file it with the committee and make it part of the record.

[The complete statement follows:]

Statement
of the
National Council of Savings Institutions
on
S. 2134, Depository Institutions Holding Company Act Amendments of 1983
and
S. 2181, Financial Services Competitive Equity Act
before the
Committee on Banking, Housing and Urban Affairs
United States Senate
February 28, 1984

Mr. Chairman and members of the Committee, my name is M. Todd Cooke, Chairman of The Philadelphia Saving Fund Society and Chairman of the National Council of Savings Institutions. This is my first opportunity to testify on behalf of the Council since it was formed November 1, 1983, through the consolidation of the National Association of Mutual Savings Banks and the National Savings and Loan League. What really gives this occasion its significance, however, is the breadth of the pending bills and the critical importance of these hearings to the future direction of financial institutions legislation.

The National Council represents over 600 savings institutions having approximately $375 billion in assets and doing business throughout the United States and Puerto Rico. Our membership encompasses a broad range of institutions including savings and loan associations regulated primarily by the Federal Home Loan Bank Board, traditional savings banks which may be FDIC, FSLIC, or state insured, as well as the growing number of savings and loan associations utilizing the provision of last year's Garn-St Germain Act to change their corporate designation to savings bank. At present, we also have a few savings banks which have converted to stock form and are registered as bank holding companies subject to the jurisdiction of the Federal Reserve Board.

The diversity of the institutions we represent stems from historical circumstances, variations in powers provided under state-chartering statutes, and management discretion in the exercise of operating powers recently gained at both the state and federal level. Reduced to simplest terms, the diversity reflects the changes, challenges and opportunities brought about by financial deregulation. Some have characterized this process as a breakdown of the distinctions among the various types of traditional depository institutions, but we prefer to view it as an evolutionary response to the demands of an increasingly sophisticated and competitive marketplace.

The National Council was founded on a common legislative and regulatory philosophy which seeks to maximize freedom of choice among providers and users of financial services. We have developed a Statement of General Principles for evaluating specific legislative and regulatory issues which is set forth in full as Attachment A to my testimony. Three aspects of that statement are particularly relevant for purposes of these hearings. First, the Council will not seek restrictions on competitors, but will seek to reduce restrictions on all depository institutions and thereby achieve "competitive equity at the highest level." Second, the Council recognizes that savings institutions will pursue different strategies to meet increased competition. Third, the Council will work to complete the process of evolution enabling savings institutions to participate fully in the marketplace of the future and provide consumers and other customers with a full range of financial services.

SUMMARY OF POSITION

Against this background, I can state that we favor additional product deregulation for depository institutions. We support and particularly appreciate the efforts of Chairman Garn to improve upon the bill that was initially submitted by the Administration. Further, we remain committed to working constructively with this Committee and the Congress to accomplish "competitive equity at the highest level," which we regard as a more worthy goal than merely achieving "a level playing field."

The National Council views with grave concern the wave of so-called "moratorium" proposals which have tended to dominate the recent policy debate over domestic banking issues. Due in large part to the strong stand which Chairman Garn and others have taken against these bills, none has progressed toward enactment and we trust that this will remain the case. It should not be overlooked, however, that certain elements of the "moratorium" proposals can be found in several of the alternative bills before the committee, including the Administration's S. 1609 and Senator Proxmire's S. 2134. Here, I refer specifically to the redefinition of the term "bank" to bring more institutions under the restrictions of the Bank Holding Company Act (BHCA), and the preemption of state laws which grant broader operating authority to depository institutions than does comparable federal law.

We can appreciate the concerns which certain regulatory officials and others in the public sector have expressed over the pace and perhaps even the direction of some of the changes that are occurring in the nation's financial system. We also acknowledge that private sector participants, including many savings institutions, remain very concerned about near-term developments. To date, we have been very fortunate that the transition to a deregulated liability structure has been implemented during a period of relatively stable and generally declining interest rates.

While numerous individual institutions still face serious problems, most thrift institutions returned to the black last year. Assuming interest rates remain at or near present levels, our Research Department estimates that 1984 will witness further improvements, both in terms of the percentage of industry members making a profit and the level of reported earnings. The specific net worth changes for savings banks are shown below, and these 1984 estimates are generally in line with expectations for the savings and loan industry as well.

Annualized Net Change in Surplus as Percent of Average Assets, Quarterly

	1st quarter	2nd quarter	3rd quarter	4th quarter	Calendar year
1984e	.14	.16	.18	.20	.17
1983	-.04	.32	.17	.12	.15
1982	-.92	-.88	-.64	-.35	-.86
1981	-.48	-.76	-1.08	-1.20	-.86
1980	.28	-.40	-.32	.04	-.10
1979	.68	.56	.44	.24	.47
1978	.60	.72	.56	.40	.57
1977	.60	.60	.56	.44	.55
1976	.40	.44	.56	.36	.44
1975	.32	.40	.44	.36	.38

Note: Data refer to net changes in surplus, undivided profits and reserves from retained earnings and exclude debentures, capital infusions from FDIC, net worth certificates, and new stock issues. Asset figures are averages for the following periods:

Calendar year -- end of December, June and December.
1st quarter -- end of December, January, February and March.
2nd quarter -- end of March, April, May and June.
3rd quarter -- end of June, July, August and September.
4th quarter -- end of September, October, November and December.

e = estimated by National Council

Should there be an upward shift in interest rates, the savings industry will plunge back into the red and managing financial deregulation will again take a back seat to achieving survival. But the point which merits emphasis in the context of today's hearing is that the evidence so far shows that deregulation is working. Depositors are benefiting in terms of higher interest rates, and credit is becoming increasingly available, albeit at somewhat higher rates than was the case under Regulation Q. Markets for both deposits and loans are becoming increasingly nationalized, if not internationalized, and this should lead to further gains in efficiency and product delivery -- developments which bear directly on the critical question of the cost at which we can make credit available to our customers. In the meantime, the essence of deregulation, namely additional financial service options for consumer and commercial customers, is taking hold quite successfully.

It is precisely for this reason, Mr. Chairman, that we find it hard to understand why, so shortly after the passage of the landmark deregulation legislation in 1980 and 1982 which made all this possible, the threat of reregulation is emerging. Notwithstanding the devastation visited upon our industry due to lack of asset diversification, we see the concept of mandated specialization resurfacing through some form of a mortgage portfolio test for thrift institutions. Not just pending legislation, but the recommendations recently agreed upon by the Vice President's Task Group on Regulation of Financial Services embody a minimum mortgage assets test for thrift institutions. Treasury Secretary Regan and Fed Chairman Volcker also endorsed such an approach when they tesified before this Committee on January 16, 1984.

I will deal at length with this issue at a subsequent point in my tesimony, but I want to emphasize at the outset that the National Council considers a statutory mortgage assets test to be an unnecessary, and quite possibly unworkable, concept that could turn back the clock on the hard fought legislative gains of the last few years.

IMPACT OF PENDING BILLS ON THE THRIFT INDUSTRY

I have already indicated, and as is clearly enunciated in our Statement of General Principles, the National Council is committed to the further deregulation of financial services. The major proposals before the Committee have as their principal goal the liberalization of the federal laws governing bank holding companies. This is a goal with which few can argue, but the impact of these bills on the thrift industry is considerably more difficult to gauge, and requires a review of the variations in definitional status under current law and regulation.

The great majority of thrift institutions (approximately 3,500 FSLIC-insured savings and loan associations and federal savings banks) are specifically exempt from the BHCA and already enjoy broad service corporation activities as determined by regulation of the Bank Board or state law. Holding companies for such institutions generally have no restrictions on their outside activities provided the parent corporation does not operate another savings association. Thus, any proposal along the lines of the Administration's bill S. 1609, which seeks to treat all bank and thrift holding companies alike, would be a step backward for the thrift industry since the list of approved activities would still be relatively narrow compared to the current operating authority of unitary S&L and federal savings bank holding companies.

By contrast, there are approximately 375 state-chartered savings banks that are neither explicitly included nor excluded from the BHCA. The question of their definitional status arises only when a savings bank converts to stock form and is owned by another company. Significantly, on December 14, 1983, the Federal Reserve Board approved a sweeping revision to Regulation Y, the effect of which is to classify virtually all such institutions as banks for purposes of the BHCA. Indeed, there are at least two holding companies, which have as their principal banking subsidiary a state-chartered savings bank, that are now registered with the Federal Reserve under the terms of the BHCA. Others may soon be moving in this direction, particularly if the Fed's December 14 ruling survives the pending judicial challenges.

There are, in addition, another 500 or so state-chartered, state-insured cooperative banks and savings and loan associations which are generally treated the same as state-chartered savings banks under the December revision to Reg. Y. On February 3, 1984, the Fed further amended Reg. Y to exempt companies owning state-insured savings and loan associations from the Bank Holding Company Act, provided the depository was acquired prior to December 10, 1982, and does not engage in lending and deposit-taking activity beyond that permitted federal thrifts under the Home Owners' Loan Act.

Insofar as any Glass-Steagall changes are concerned, thrift institutions are likewise treated differently than commercial banks, or at least those which are members of the Federal Reserve System. Both the FDIC and the FHLBB have ruled that the Glass-Steagall Act's prohibitions do not apply to subsidiaries of nonmember institutions. This means that savings banks and savings and loan associations may engage in securities activities beyond discount brokerage which is now authorized for all depository institutions.

Thus, all the pending bills (S. 1609, S. 2134 and S. 2181) present the anomaly of being deregulatory for registered bank holding companies, but actually restrictive insofar as most thrift institutions are concerned. This would be especially true for those thrift institutions which now enjoy broad operating powers under state-chartering laws. The glaring defect in the Treasury's initial proposal was that it sought to treat all thrift institutions, regardless of how they might be exercising their new powers, on the same restrictive terms as banks registered under the BHCA. This is clearly a case of leveling the playing field downward rather than upward, as we would recommend.

Seeking "competitive equity at the highest point" is by no means a novel approach. For example, it will be recalled that when the Congress was confronted in 1982 with the difficult task of redressing the competititve imbalance between depository institutions and unregulated money market mutual funds, the decision was made to accelerate the phase-out of Regulation Q rather than subject the money market funds to federal interest rate controls. The $130-140 billion that have since flowed into Money Market Deposit Accounts at savings institutions has amply demonstrated that Congress made the right decision in choosing to equalize market participants upwards rather than leveling towards the most restricted competitor.

Applying the principle of "competition at the highest level" to the broader subject of financial services, it follows that we should be moving the Bank Holding Company Act in the direction of the federal statutes governing thrift holding companies, and ensuring that the restrictions which may remain under the BHCA apply only to institutions which are performing substantial commercial banking functions.

As noted, the Savings and Loan Holding Company Act generally permits institutions, subject of course to safety and soundness standards, to be affiliated with any other type of business corporation. The experience under this approach has been virtually unmarred by major difficulties, which argues persuasively that this should be the model if we are truly to make progress in keeping our banking laws ahead or at least abreast of competitive realities. In our view, S. 2181 takes two very important steps in this direction. First, it places state-chartered, FDIC-insured savings banks under the jurisdiction of the Federal Home Loan Bank Board rather than the Federal Reserve Board insofar as their holding companies are concerned; and second, it preserves the unitary S&L holding company treatment for so-called "qualified thrift lenders." The significance of the "qualified thrift lender" concept is that it focuses on what institutions are actually doing in the marketplace, as opposed to S. 1609 which was constructed on the flawed premise that the Garn-St Germain Act had automatically transformed all the nation's thrifts into commercial banks.

I will be commenting more fully on the qualified thrift lender test, but, for now, I would like to express the Council's endorsement of both of the above-mentioned features of S. 2181. In fact, if state-insured institutions are to be covered, then we would suggest that Sections 104 and 108 of the bill be further amended to treat state-insured thrift institutions, whether they be savings banks, cooperative banks or savings and loan associations, on the same terms as federally-insured thrift institutions. In order to achieve full consistency in the treatment of thrift institutions, federal law should also be amended to permit state-chartered savings banks to be eligible for FSLIC insurance.

As previously noted, the Federal Reserve Board swept state-insured thrift institutions into Reg. Y when it acted last December to close off the so-called "nonbank bank" loophole -- an action which we believe was unnecessarily broad. There are approximately 600 institutions of this type doing business primarily in Maryland, Massachusetts, North Carolina and Ohio, and only a mere handful were exempted by the additional amendment to Reg. Y that was adopted by the Board on February 3, 1984.

NEW FINANCIAL SERVICES

I would now like to address the major issue of general interest at today's hearing, namely product deregulation. Simply stated, the National Council supports expanded operating powers for all types of depository institutions. Our predecessor organizations -- the National Association of Mutual Savings Banks and the National Savings and Loan League -- have long been identified with the effort to broaden the authority of thrift institutions and that process is far from complete for depositories in general. Entirely too much time and cost is now required for institutions to weave their way in, out and around the Bank Holding Company and Glass-Steagall Acts, as well as related federal laws which seek to compartmentalize the financial services industry. I would like to single out three particular areas for consideration by this Committee in any future action involving specific legislation.

First, Savings Bank Life Insurance (SBLI) which may now be offered only in the States of Connecticut, Massachusetts and New York, should be made available on a nationwide basis. Consistently rated at or near the top in terms of consumer value by every independent study, SBLI is perhaps the best example one can find of the benefits to be gained by permitting institutions to combine the delivery of different financial products. This is how Consumer Report summed up this unique consumer service in a study published in February, 1980:

> "Special bargains are available to some buyers. Residents of Massachusetts, or people who work there, have an excellent buy available in the form of Savings Bank Life Insurance, sold by savings banks. Savings Banks in New York and Connecticut also offer low-priced life insurance."

A second service area that can likewise be expected to have a pro-competitive impact is allowing depository institutions to underwrite mortgage-backed securities. Because of their considerable institutional expertise in the mortgage area, we believe that thrift institutions could make a major contribution to this fast growing area of the securities business. If properly structured, underwriting authority could also be of assistance to thrift institutions seeking to restructure their mortgage loan portfolios. We are pleased that both S. 2181 and S. 2134 contain this authority.

On this subject, I might add that while the National Council does not object to the Senate-passed bill S. 2040 which would facilitate the mortgage market operations of securities firms, there does appear to be a substantial question of fairness involved here. That legislation is being processed toward completion while depository institutions continue to operate under the restraints of the Glass-Steagall Act, as supported by the securities industry. The rules should be liberalized simultaneously for both types of institutions.

Third, we support the authority contained in both S. 1609 and S. 2181 regarding cross-industry acquisitions between banks and savings institutions. A number of states have already moved in this direction, and with the likelihood of increased merger activity in the years ahead, we see no reason to maintain barriers at the federal level to institutions seeking to exercise these options under state law. For example, the purchase of a commercial bank can frequently be the most feasible way for the thrift institution to implement the commercial lending authority permitted under both federal and state law. Operating the commercial bank as a separate subsidiary can be accomplished by some state-chartered thrifts under current law, but the overall subject is one which could benefit from some streamlining.

HOLDING COMPANY STRUCTURE

The original Treasury bill, S. 2181 and S. 2134 all rely upon the holding company device as the vehicle for expanding the powers of depository institutions. As such, the bills would exclude mutual institutions from the exercise of new financial service powers, although S. 2181 would permit mutuals to continue to exercise such service corporation powers as may be authorized under federal or state law. The predecessor organizations to the National Council have previously testified before this Committee as to the exclusionary and discriminatory impact which the holding company approach would have on mutual institutions which constitute over 70 percent of the thrift industry. The National Council continues to object to legislative proposals which are biased toward the stock form of corporate organization.

Stock conversions are on the increase and have contributed significantly to the much-needed recapitalization of the industry. However, this trend should be encouraged by positive incentives rather than by withholding new powers from mutual institutions. As we have repeatedly stressed, there are many institutions which by reason of tradition, market conditions, or management preference, will continue to operate in mutual form as viable business entities for many years to come. The insurance industry well demonstrates that mutual and stock institutions can compete in precisely the same lines of business without the need for arbitrary distinctions to be drawn on the basis of their corporate form.

Should this Committee be persuaded that federal deposit insurance or some other feature of the banking business requires a separation of corporate functions, then we suggest that the S&L service corporation or any other "downstream" subsidiary is perfectly suited to accomplish this purpose. Alternatively, a holding company structure for mutual institutions needs to be developed in order to permit all depository institutions to be full participants in any changes that may be made in federal law regarding the powers of depository holding companies.

The Chairman's floor statement accompanying the introduction of S. 2181 called for exploration of the mutual holding company concept, and we are pleased to include with our testimony a specific proposal along these lines. As described in Attachment B, the approach is simply to shift the mutual corporation one level up, and empower it to hold the nonpublic stock of the depository institution that was formerly organized in mutual form. After an initial capitalization from the existing depository, the parent mutual would then function on the same terms contemplated for stock holding companies under any of the pending bills. Corporate governance, including depositor voting where it is currently recognized under state or federal law, would also be shifted to the holding company level.

I would reiterate, however, that we put forth this proposal as a means of participating constructively in the legislative process, and not because we consider it the preferable way of proceeding. The service corporation has proved to be an ideal diversification tool for the thrift industry which Congress should enhance at the earliest opportunity by raising the unrealistically low percentage-of-assets limitations and removing the other restrictions now found in federal law.

THE DEFINITION QUESTION

I would now like to discuss what we consider to be the most critical aspect of the pending bills insofar as the thrift industry is concerned, namely the proposed asset test for distinguishing between commercial banks and thrift institutions. It is frequently said that generals are prone to fighting the battles of the last war, and in a sense this is what we are doing in attempting to define the terms "bank" and "savings institution" which may already be obsolete. As an example, I would point to a Buffalo-based institution which was organized as a savings bank but now does business in four states, technically, as a federal savings and loan association. Its corporate name is simply "Empire of America" thereby avoiding any of the labels which we are struggling to define for purposes of drawing legal and regulatory distinctions. Devising any type of test is a very troublesome undertaking which poses the real danger that we might end up forcing institutions to conform to a pattern preordained in Washington, D. C., rather than having our supervisory structure adjusted to accommodate the changes occurring in the marketplace.

On this point, Mr. Chairman, I want to express our concurrence in the view which you have publicly expressed that action on the recommendations of the Bush Task Group should be deferred until the present effort regarding new powers has been settled. We note with considerable concern that the Bush Task Group has also recommended a "thriftness" test, similar to the one set forth in Senator Proxmire's bill, which focuses exclusively on residential real estate loans and mortgage-backed securities.

We respectfully submit that the question of an asset test can and should be viewed separately when one is discussing powers as opposed to regulatory treatment. In the context of the pending legislation which seeks to liberalize but still preserve the basic separation between banking and commerce, the question is: which institutions should be treated as commercial banks? In the regulatory context, the question is: which institutions should be eligible for membership in the Federal Home Loan Bank System? Since the pending bills deal almost exclusively with bank holding company powers, we believe that the Congress should focus on defining a commercial bank rather than attempting to define a thrift institution.

In testimony before this Committee on January 16, both Fed Chairman Volcker and Treasury Secretary Regan expressed the view that the only institutions which should be exempt from coverage under the BHCA are those with a very high percentage of assets in residential mortgage loans. Since it was first enacted in 1956, through almost 30 years of administration, the BHCA has never had anything to do with mortgage lending. Therefore it is inappropriate and illogical for the two to be linked in the manner which Chairman Volcker and Secretary Regan have suggested.

Reference to the current definition contained in the BHCA may be helpful at this point. As is well known, the test is a conjunctive one which focuses on both the liability and the asset side of an institution's balance sheet. If an institution is not specifically exempt, it must accept both demand deposits and engage in the business of commercial lending in order for its parent corporation to be subject to the restrictions of the Act. This definition is consistent with a well established line of judicial cases established by the Supreme Court in U.S. v. Philadelphia National Bank 374 US 321 (1963), which categorized commercial banking as a unique "line of commerce". Even though these cases have evolved primarily in the antitrust field, they also focus on both demand deposit and commercial lending functions. As summarized by one commentator:

> [t]he Supreme Court was particularly impressed by the "distinctive power" of banks to accept demand deposits. The Court also gave emphasis to the ability of banks to "create" money. In the introductory portion of its opinion, the Court stated that among the services offered by commercial banks the most important were "the creation of additional money and credit, the management of the checking account system, and the furnishing of short-term business loans."1/

Thus the statutory language, related judicial decisions and, indeed, simple common sense tell us that commercial lending is the hallmark of commercial banking, and the only logical asset test for determining which institutions should fall under the Bank Holding Company Act.

1/ Golembe Associates, Inc., Commercial Banking As a Line of Commerce (December, 1980)

This approach is also consistent with the administrative case law that has developed under the Federal Reserve Board's regulatory interpretations of the Bank Holding Company Act. The first enunciation of the test, as it applied to thrift institutions, was in a March, 1982, decision involving an application by First Bancorporation, Salt Lake City, to acquire Beehive Financial Corporation. 2/ In that case, the Fed concluded that state-chartered thrift institutions would be considered "banks" if their commercial lending activity exceeded that permitted under federal law (then 5 percent of assets for federal savings banks).

Several more recent decisions involving state-chartered savings banks in New Hampshire 3/ have reinforced this doctrine with the aforementioned result that some savings banks, which have significant commercial lending departments or which have become affiliated through stock conversion with a commercial bank, are now doing business as bank holding companies registered with the Federal Reserve Board. As recently as February 3, 1984, the Fed once again confirmed its standing interpretation under the BHCA that commercial lending is the key asset criteria in determining "bank" status by exempting certain state-insured savings and loan associations from coverage under the revised Reg. Y provided their commercial lending activity does not exceed that permitted under federal law (currently 10% for both federal savings and loan associations and federal savings banks).

I trust it is clear, Mr. Chairman, and members of the Committee, that in arguing for a commercial loan test, we are not attempting to have it both ways. The Congress and many states have responded admirably to the need for

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2/ 68 FR Bull. 253, reversed on other grounds, First Bancorportion v. Bd. of Governors, USCA, Tenth Circuit, No. 82-1401 (February 21, 1984).

3/ See, e.g. Amoskeag Bank Shares 69 FR Bull. 860 (1983).

the thrift industry to diversify into areas historically reserved for commercial banks. As these powers are actually implemented to a substantial degree, we are quite willing to play by the same rules as commercial banks and to aid in the process of having these rules liberalized.

We must object most strenuously, however, to the effort by regulatory officials to turn this debate on its head by seeking to define a thrift institution through a statutory mortgage test and then treat all institutions failing that test as commercial banks. Such an approach would represent the worst of both worlds for a nonqualifying thrift institution since it would then be subject to regulation as a commercial bank but would still not be granted full commercial banking powers such as unlimited commercial lending and demand deposit authority.

Nor should our position on the statutory mortgage test be interpreted as an antihousing point of view. Savings institutions will never turn their backs on housing finance, the area of our greatest expertise. We anticipate, and indeed the evidence already shows, that deregulation will enable us to serve housing markets better by affording us increased flexibility and broader services and powers. In viewing this issue, one must always keep in mind the other side of the balance sheet, namely, our consumer savers who will not stay with us should their rates of return suffer from the vagaries of the housing market. We must first be able to attract savings at competitive rates, if we are to continue to finance housing and serve other essential credit needs.

For all of these reasons, Mr. Chairman, we support your approach to defining a qualified thrift lender in a manner that incorporates the commercial loan feature.

PROBLEMS WITH A MORTGAGE TEST

Even if it could be justified on a conceptual basis, a test relying solely on mortgage holdings would suffer from a number of practical difficulties. First, market conditions vary widely across the country and change frequently. A reasonable test for institutions in one marketplace at one time may be prudently unattainable in another marketplace at another time. Largely on this basis, the concept of a uniform nationwide standard that would apply to 4,000 thrift institutions from Maine to California and everywhere in between has been specifically rejected in the past by both the Congress and the Federal Home Loan Bank Board.

In 1978 when Congress was first approving federal charters for savings banks, a specific amendment was offered during committee consideration in the House that would have required federal savings banks to invest 60 percent of their assets in mortgages. After considerable debate, the amendment was rejected by a recorded vote. In 1979, the Federal Home Loan Bank Board held a hearing on regulations to implement the federal chartering authority which included a reexamination of the feasibility of a 60 percent test. The Bank Board likewise rejected the approach as unworkable stating that:

> "a rigid quantitative home-financing test would prevent the Board from taking into account local circumstances and conditions." (44 Federal Register 36015)

If an asset test made no sense five years ago when thrift institutions had the benefit of Regulation Q, not to mention an interest rate differential over commercial banks, how can it possibly make sense in 1984 when full deregulation of liabilities will soon be in place. In fact, Mr. Chairman, one might pose the question of what economic or public policy rationale exists for any asset limitations on depositories once we have completed the deregulation of liabilities? Deposit insurance is one obvious answer, but if that is the case, then the next question is why are thrift institutions being singled out by S. 2134 and the Bush Task Group for a mandatory reinvestment standard? Commercial banks and credit unions also have federal deposit insurance and federally-sponsored credit facilities in the form of the Fed discount window and the NCUA Central Liquidity Fund. We recognize that there are differences in the administration of the discount window and the CLF as compared to the Bank Board's advance system, but these are differences of degree not of kind.

A second problem is that the mortgage test, while designed to promote housing, does not take into account an institution's secondary market activity. A savings bank or savings and loan association could be the most active housing lender in its market, but if it chose to sell those loans into the secondary market, as many now do, it could still fail a "thriftness" test based on static portfolio holdings. Perhaps a flow of funds test could be developed, as was the case under the All Savers Act, but this would be a rather complex undertaking.

A third problem and, in the long run, perhaps the most serious flaw with a mortgage test is that it fails to take cognizance of the fact that mortgage finance has become an integral part of the national capital markets. Indeed, it may be said that housing finance has gone international with GNMA mortgage-backed securities recently being introduced into new foreign markets in the Far East and elsewhere. At home, a whole host of players, new and old, are now in the mortgage market, including commercial banks, mortgage bankers, securities firms, insurance companies, credit unions and finance companies. The technology is such that builders and realtors can and now are teaming up with investment bankers and going directly to the capital markets via builder bonds, Shelternet, etc., bypassing traditional mortgage credit providers.

Last year, savings and loan associations originated approximately 50 percent of the mortgages made in the U.S., and were net sellers in the secondary market. Thus, it follows that if Congress is serious about a 60 percent portfolio test for savings institutions, it will have to restrict entry into the mortgage market by our competitors in housing finance. Such a course would not only be the opposite of what the present Congress is trying to accomplish with bills such as S. 2040, but it obviously would represent a reversal of pro-housing policies recommended by every major study of the subject area over the last 15 years.

The central finding of all these studies is that forced specialization tends to destabilize rather than foster housing investment. Insofar as the remedy is concerned, the Hunt Commission stated it as follows:

> "The Commission seeks to abolish specialization forced by statute and by regulation. The Commission in no way seeks to inhibit the right of institutions to specialize if they so wish.
>
> * * * * *
>
> "The Commission's objective then, is to move as far as possible towards freedom of financial markets and equip all institutions with the powers necessary to compete in such markets."[4]

More than ten years of work at both the state and federal level has now moved us in the direction identified by the Hunt Commission and other earlier studies. While a great deal more remains to be done, we are not aware of any major study in the field which concludes that we reverse course. Thus, it is not surprising to see that the most recent study, namely the April, 1982, Report of President Reagan's Commission on Housing, contains no mention of instituting a minimum portfolio test for thrift institutions. In fact, that report, which is to be commended for its reliance on a free market approach to promoting housing and housing finance, concluded that the proper direction is to liberalize the incentives now found in the tax code for mortgage investments since they have become outmoded by virtue of the financial deregulation that has already occurred. We concur that the focus should be on modernizing the tax treatment for mortgage lenders, not erecting a parallel test in the banking code.

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[4] E. g., Report of the President's Commission on Financial Structure and Regulation (December 1971), p. 9.

To sum up on this point, Mr. Chairman, the National Council is of the view that a mortgage asset test is inappropriate in the context of a holding company powers bill, and while it may be more relevant in a regulatory context, even then it will be very difficult to reduce to workable form.

OTHER PROVISIONS OF THE PENDING LEGISLATION

S. 2181 deals with a number of issues other than financial service deregulation. On some of these issues the National Council already has an established position, whereas on others, such as the consumer bank, we are in the process of developing a policy at our Government Affairs Conference which is currently meeting in Washington, D. C. In the remainder of my testimony, I will be glad to address those issues included in the pending legislation on which we have an established position, and I would request permission to submit subsequently for the record our policy positions on new issues or modifications to present policies that stem from our February 26-29 meeting.

Interest on Reserves

Earlier I referred to the equalization of competition between regulated depository institutions and money market mutual funds that was brought about through the creation of the Money Market Deposit Account (MMDA) by the 1982 legislation. In one respect, however, money market funds still enjoy a competitive advantage since depository institutions are subject to reserve requirements which can be as high as 12 percent for those MMDAs with full transaction features.

The National Council supports Title IV of S. 2181 which would authorize the Federal Reserve Board to pay interest on MMDAs, and we commend Senator Heinz for the leadership he has provided on this issue. I would also point out that this Title well exemplifies the principle of "competitive equity at the highest level" since it would allow depository institutions to maintain these reserves as earning assets, rather than subject money market mutual funds to sterile reserve requirements.

Interest on Demand Deposits

Closely related to the question of interest on reserve requirements is Title VIII of S. 2181 which would repeal the federal prohibition on the payment of interest on demand deposits. The principle involved in both proposals is the same, namely explicit pricing for the use of funds. The National Council supports both the removal of the present prohibition on the payment of interest on demand deposits and the authorization of NOW accounts for all types of depositors. At the same time, we are sensitive to the need to phase in the additional deregulatory step represented by a repeal of the prohibition on the payment of interest on demands deposits, and we would therefore support an orderly phaseout so as to avoid an adverse short-term impact on commercial banks and other depository institutions which currently hold large amounts of demand deposits.

I would like to mention, however, that Section 804 is deficient, in our judgment, because it repeals the prohibition on paying interest on demand accounts held by federal savings associations, without affirmatively authorizing federal associations to offer demand deposits to all types of customers. Congress should take this occasion to eliminate the anachronism in current law which limits demand deposits at federal thrift institutions to business customers.

Usury Ceilings

Title VII of this legislation would reinstate the federal preemption of usury ceilings on business and agricultural loans, and enact a new federal prohibition on state laws imposing usury ceilings on consumer credit. It is well documented and by now generally accepted that, in the long run, usury ceilings hurt the consumer by curtailing the availability of credit. Now that we have moved to a deregulated liability environment for depository institutions, there is even less economic justification for continuing to tolerate this type of market artifice. The National Council recognizes that many states have acted on their own to repeal usury ceilings, but we believe that a uniform federal preemption makes sense.

Delayed Funds Availability

The National Council has not yet taken a position on the pending legislation, incorporated as Title VI of S. 2181; dealing with customer access to funds which have been deposited for collection. On January 31, 1984, the Council mailed the proposed legislation (S. 573) to all of its members soliciting an operational analysis of compliance with the bill's disclosure and other provisions. The comments we have received to date indicate that serious difficulties would be encountered by depository institutions in meeting the requirements of the bill as presently drafted. Section 606 of the legislation, requiring the payor bank to provide direct notice within 24 hours to the initial collecting bank whenever a third-party item in the amount of $250 or more is dishonored, has been singled out as a source of particular concern.

We recognize that the Congress has received expressions of constituent concern on this issue and that two major banking states, namely California and New York, have already adopted legislation on check-crediting practices. Other states such as Florida and Maryland also have the matter under active consideration, but we think it is important to keep in mind that, as is frequently the case, this is a question of a few institutions tarnishing the entire industry. For this reason, our membership communication on S. 573 also urged individual institutions:

> "to review their practices in this area to ensure that 'hold' policies are reasonable and consistent with advances that have occurred in the payments system. Of equal, if not greater importance, depository institutions should be certain that customers are made aware of check-crediting practices."

Regional Branching

The growing trend among the states to liberalize their branching statutes to include interstate activities on a reciprocal, regional or other basis, is one of the most significant deregulation steps now underway. The most notable of the regional efforts is the so-called New England experiment, and Title X of S. 2181 is intended to provide a federal sanction to state initiatives of this type.

The National Council supports interstate branching which would include regional branching experiments which move in this direction. A drafting difficulty does arise in the context of Title X because federal thrift institutions, unlike commercial banks, do not presently operate under any statutory prohibition on interstate deposit-taking. Sections 1004 and 1005 could be interpreted to curtail the present branching authority of federal associations and their holding companies because they explicitly authorize branching only in those states which permit out-of-state entry. Appropriate clarification to ensure that this Title of S. 2181 does not curtail the present branching authority of federal thrifts will be necessary.

CONCLUSION

In conclusion, Mr. Chairman, I would reiterate our commitment to broadening the range of financial services which may be offered by depository institutions. Building on the base established by the Garn-St Germain Act of 1982, many states have already moved well beyond the present status of federal law insofar as the operating powers of thrift institutions are concerned. This trend is a recognition of the fact that savings institutions need maximum flexibility to make up for past problems stemming from overspecialization.

The pending legislation is designed primarily to expand the powers of commercial banking organizations, but it will have quite a differant impact on savings institutions. To begin with, the holding company approach discriminates against mutual institutions. To the extent that the bills flow over to federal and state law governing thrift institutions, there is the danger that new restrictions will arise.

In addition, we must be very careful to guard against any federal legislation that would establish a system which penalizes institutions for a perceived lack of housing commitment. Such an approach can only exacerbate the already difficult intermediation function which savings institutions must perform in the face of growing competition from both traditional and nontraditional sources.

Savings institutions will always have a major housing and community orientation. But to impose an investment requirement on thrift institutions while our competitors remain unfettered is to forget the painful disintermediation and severe earnings problems of the recent past. The thrift industry has paid an enormous price to learn that public policies designed to promote housing in a manner contrary to rather than consistent with free market forces, simply do not work. I urge this Committee in the strongest possible terms not to take us down that road again.

ATTACHMENT A

NATIONAL COUNCIL OF SAVINGS INSTITUTIONS

Statement of General Principles

The National Council of Savings Institutions is dedicated to the principle that depository institutions should be able to compete effectively and fairly in the rapidly changing financial services marketplace as it exists today and as it evolves in the future.

The Council recognizes the revolutionary changes which have occurred in consumer and business demands for financial services. Today's customers expect: a market rate return on their savings and transaction accounts; ease of access to their funds; and, flexibility in allocating these funds among different investment media. They also demand convenience and efficiency in meeting their housing, personal, business and other credit needs. Savings institutions should be able to provide a complete range of services to meet these demands.

The Council will work vigorously for the creation of a legislative and regulatory climate which will enable savings institutions to serve this market. It will work for further deregulation of product and geographic restrictions which inhibit the ability of savings institutions to compete. The Council will not advocate restrictions on competitors, but will work to relieve restrictions on all depostiory institutions and thereby achieve competitive equity at the highest level.

The Council recognizes that savings institutions will pursue different strategies to meet increased competition in the maketplace. Some will choose to expand in their immediate market area, while others will operate on a regional, national and even international basis. Some will wish to broaden products and services, while others will choose to specialize.

The Council will work to develop public policies which will enhance this freedom of choice — including meaningful regulatory alternatives. Traditionally, an institution's charter predetermines its approach to business. Today, market area, market demands, management expertise and regulatory distinctions are key factors in determining business direction. Acknowledging the varied missions of savings institutions, the Council will stress flexibility and charter options as needed by the industry.

The Council is cognizant, and recent times have amply demonstrated, that a strong capital base is essential for an institution to survive the vagaries of the financial markets and to position itself to keep up with changing consumer needs and other financial demands. Therefore all legislative and regulatory issues must also be considered from the standpoint of their effect on profitability of institutions. Access to the capital markets is also critical for the continued safety and soundness of financial institutions and the sanctity of the federal deposit insurance funds.

The Council will work to complete the process of evolution enabling savings institutions to participate fully in the marketplace of the future and to provide consumers and other customers with the full range of financial services.

Adopted by the Board of Directors of the National Council of Savings Institutions at its meeting on December 6, 1983, in New York.

ATTACHMENT B

HOLDING COMPANY PROPOSAL
FOR THE
MUTUAL THRIFT INDUSTRY

FOREWORD

Consideration of a holding company structure for mutual depository institutions is prompted by the recent trend in legislative and regulatory proposals to focus on the holding company as the vehicle for expanding the powers of banking organizations. In response to this development, a study group was created in December 1982, by the National Association of Mutual Savings Banks to examine the feasibility of this concept. This proposal is the result of that effort and reflects the contribution of the many individuals listed in Appendix C. A special acknowledgement goes to Jerry Buckley, Washington Counsel to the Savings Banks Association of Massachusetts, for his work on this project.

James J. Butera
Vice President
Legal and Governmental Affairs

November 1983

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SUMMARY SHEET
MUTUAL HOLDING COMPANY PROPOSAL

Problem:

1. At the urging of the Administration, legislation is being promoted that would accomplish further bank services deregulation through holding company subsidiaries, i.e. affiliated companies that are not "downstream" from the federally insured entity.

2. Commercial banks doing business in holding company form have no major problem with this approach and the same would be true for S&L holding companies. Other stock depository institutions would be required to establish a holding company in order to take advantage of this approach to diversification, but most institutions of sufficient size can accomplish this with minimum administrative costs.

3. Mutual depository institutions, on the other hand, do not currently have a corporate structure which lends itself to an "upstream" holding company structure, and could thus be excluded from future business opportunities if the bank-supported Administration plan becomes law.

4. Although most statutory impediments to mutual-to-stock conversion have been removed, there are many depositories which by virtue of historic structure, management preference or market conditions will continue to do business as mutual institutions in the years ahead.

Objective:

1. In order to preserve the competitive posture of th thrift industry, it is essential that any new operating powers be granted across the board to depository institutions regardless of type or corporate form.

2. If the thrift industry is to work in concert with the Administration and commercial banks, a mechanism must be developed to permit mutual depository institutions to establish a "parent" company capable of carrying out these new activities through securities, insurance, real estate development and other subsidiary corporations.

Solution:

1. Rather than being internally managed as is now the case, mutual depository institutions could transfer this responsibility to a mutual holding company which would act in a capacity analogous to a traditional bank holding company.

2. The mutual holding company would be created by having the depository institution establish a new subsidiary and then transfer its assets and liabilities to this new corporation in a manner similar to the well-established procedure of efffecting a "phantom" bank merger. The mutual corporation continues in existence, not as a bank or savings institution, but as the holder of the non-public stock of a depository institution.

3. Initial capitalization of the holding company would be accomplished by retaining a portion of the assets of the insured depository at the holding company level. After this one-time capital contribution, further funding of the holding company would be through earnings generated by the subsidiaries and other normal capital market techniques.

4. Mutual holding companies would be authorized to engage fully in the same activities permitted stock holding companies under the Administration's bill.

INTRODUCTION

The expansion of bank activities has a long and controversial history with groups ranging from insurance agents, data processors and, at times, thrift institutions themselves working to oppose the entry of commercial banks into their particular line of business. During consideration of the 1970 amendments to the Bank Holding Company Act (BHCA), when the principal purpose was to extend coverage to one-bank holding companies, a compromise was struck that led to enactment of the current "closely related" test for nonbanking activities.1/ The activities approved to date under this standard have been fairly limited, and in addition, the BHCA calls for prior Board approval whenever a nonbanking activity is to be undertaken or expanded to a new geographic location.2/

Notwithstanding the fact that in 1982 the insurance agents successfully concluded a 10-year campaign to limit bank holding company authority to act as an agent for credit-related property and casualty insurance,3/ pressure has been steadily building to liberalize the BHCA. Under the sponsorship of the Administration, a specific proposal along these lines was introduced in the last Congress as S. 2490, the Bank Holding Company Deregulation Act. No serious effort was made to move S. 2490 in light of the preoccupation with the Garn-St Germain legislation and the related controversy over Glass-Steagall amendments.

The comprehensive banking legislation enacted in 1982 appears to have substantially settled two major deregulatory issues, namely interest rate phase-out and limited commercial bank powers for thrifts. With these steps completed, greater attention is now expected to be given to legislative initiatives expanding the types of financial services which all depository institutions may offer. Broader securities powers are at the forefront of this effort, but there are a number of other lines of business involved including insurance, and real estate development. Indeed, the legislative language under consideration would replace the current "closely related to banking" test with much broader authority for holding companies to undertake any "services of a financial nature."

I. THE SEPARATE SUBSIDIARY CONCEPT

Given its continued commitment to deregulation, the Administration resubmitted its "financial services" bill in this session of Congress as S. 1609 (the companion bill is H.R. 3637). The new bill contains a number of changes from S. 2490, notably in its treatment of thrift institutions. However, the important point for present purposes is that it reaffirms the Administration's decision, for reasons both substantive and political, to seek further deregulation of the financial industry through the holding company

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1/ 12 U.S.C. 184(c)(8).

2/ 12 CFR 225.4(a).

3/ Act of Oct. 15, 1982, Pub. L. 97-320, Sec. 601; 12 U.S.C. 1843(c)(8).

device rather than expanding the powers of depository institutions per se. In testimony before the Senate Banking Committee, Treasury Secretary Donald T. Regan summed up this position as follows:

> "Our approach to deregulation ... establishes the holding company vehicle as a means to expand the activities of bank holding companies generally and securities subsidiaries in particular."4/

On the substantive points, the Comptroller of the Currency, C. Todd Conover, has identified three major arguments in favor of the separate subsidiary approach:

> "First, the holding company framework permits the isolation of higher risk activities from the traditional functions about which government has been so consistently concerned; lending for commerce and safety for savings.
>
> "Second, the holding company framework permits the creation of the infamous level playing field. Competition between bank holding company subsidiaries and non-bank institutions could be conducted under the same ground rules. If a holding company subsidiary provides commodities services, it would be regulated by the Commodities Futures Trading Commission. Subsidiaries providing securities services would come under the jurisdiction of the Securities and Exchange Commission. None of the subsidiaries would be able to take advantage of the competitive edge banks enjoy as a result of deposit insurance. By the same token, subsidiaries would not be bound by banking restrictions.
>
> "Finally, the holding company framework may provide a more effective mechanism for managing new financial activities. It permits management to set up the new activities in separate profit centers. It allows the establishment of different compensation systems for different specialties. It makes possible some variation in corporate culture. It may even make it easier to attract good people to lead and staff the subsidiary companies."5/

Prior to the formalization of the holding company approach to bank expansion in S. 2490, there were a number of developments pointing in this direction. The Bank Expansion Quarterly, a publication of Golembe Associates, has been arguing for years that the only way to expand bank activities without expanding bank examination and regulation is to use the holding company device.6/ In the related area of geographic expansion, the comprehensive

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4/ Financial Institutions Restructuring and Investment Act of 1981: Hearings on S. 1720 et al. before the Comm. on Banking, Housing and Urban Affairs, U. S. Senate, 97th Cong., 1st Sess., 15 (1981).

5/ Remarks by C. T. Conover, Comptroller of the Currency, before the Association of Bank Holding Companies, in Washington, D. C. (Nov. 19, 1982).

6/ Carter H. Golembe, "The Regulation of Commercial Bank Expansion" BEQ, July 5, 1982.

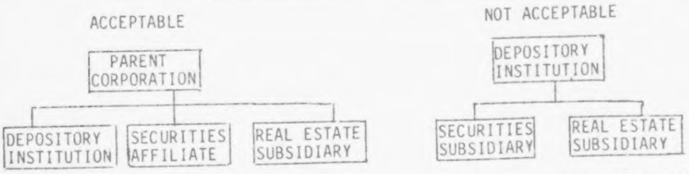
branching study completed by the Treasury in January 1981, suggested that interstate banking be authorized by permitting holding companies to make interstate acquisitions as opposed to amending the McFadden Act to permit banks to branch directly across state lines.[7] Finally, Congress itself gave legislative sanction to the holding company approach to bank expansion by enacting the Bank Export Services Act of 1982, which authorized bank holding companies, but not banks, to take equity positions in trading companies.[8]

Substantive arguments notwithstanding, a major reason for the growing acceptance of the separate subsidiary concept is that it represents "middle ground" between those supporting and those opposing bank expansion. Key legislators on both sides of the issue seem to view the separate subsidiary concept as basic to any potential bill, including Senator Chafee (R-RI), the principal sponsor of Glass-Steagall changes in the last Congress, and Senator Heinz (R-PA), who has been among the most concerned about proposed Glass-Steagall changes.

The Association of Bank Holding Companies has already endorsed the separate subsidiary concept, and the American Bankers Association -- in a step representing a recent policy reversal -- has taken a similar position. In recognition of the political realities, the Dealer Bankers Association, the lobbying group which has made municipal bond underwriting its principal legislative focus, has also come around to accepting the separate subsidiary concept.

It should be emphasized that by separate subsidiary the Treasury means a subsidiary of the holding company and not a subsidiary of the insured depository institution itself no matter how many steps removed. Portrayed in diagram form below is the separate subsidiary concept as it is viewed by the Administration and many congressional leaders.

SEPARATE HOLDING COMPANY SUBSIDIARY



On this point, the Treasury has been steadfast, as typified by the following excerpt from an October 28, 1982, speech by Deputy Secretary McNamar before the Bank Administration Institute:

> "Entry by banks into non-banking activities could also jeopardize bank soundness, whether the bank enters the field directly or through a subsidiary of the bank in which it invests its bank capital. In either case, banks themselves would be taking commercial risks, not banking risks.

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[7] Geographic Restrictions on Commercial Banking in the United States: The Report of the President, 17 (January 1981).

[8] Act of Oct. 8, 1982, Pub. L. 97-290.

> "Clearly, it is inappropriate for organizations whose liabilities are insured by the Federal government to be taking commercial risks in competition with enterprises which are less heavily leveraged than an insured bank, and which must raise capital at the commercial paper rate, a spread over LIBOR, or in the long term corporate bond market.
>
> "The Federal deposit insurance agencies' risks are protected not only by the premiums they collect but also by their supervision of bank activities restricted by law to those that are manageable within the agencies' resources and the need to maintain public confidence in the system. In short, the price of the Federal insurance is a restriction on activities." (Emphasis added.)

A further indication of the political acceptance which the separate subsidiary concept has achieved is the fact that Senator Garn's recently introduced revision of the Administration's bill retains the holding company approach to financial deregulation.[9] Moreover, Senator William Proxmire, the Banking Committee's senior Democrat, has also introduced an alternative bill to S. 1609, which likewise utilizes the separate holding company subsidiary for purposes of expanding the securities powers of banking organizations (S. 2134).

II. THRIFT INDUSTRY POSITION

To date, savings banks and savings and loan associations have not been active participants in the debate over proposed modifications to the Glass-Steagall Act. There are a number of reasons for this, the most prominent of which is that thrift institutions, by virtue of several recent regulatory actions, have been treated as institutions not covered by the Glass-Steagall Act insofar as securities affiliates are concerned. On this basis, for example, the Federal Home Loan Bank Board approved the INVEST system of discount brokerage and limited investment advice for S&L service corporations.[10] In addition, the FDIC has ruled that insured nonmember banks, including savings banks, may establish full service securities subsidiaries.[11] Both these rulings are being contested, but in the meantime institutions are taking advantage of these rulings to enter new lines of business.

Of course this year's legislation goes well beyond securities powers and contains an affirmative list of new authorities including insurance and real estate development. There is also the residual authority vested in the Federal Reserve Board, under the terms of S. 1609, to approve additional activities deemed to be "of a financial nature". As described by Treasury Secretary Regan in testimony before the Senate Banking Committee, the residual authority is intended:

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[9] S. 2181, 1st Sess., 98th Cong. (Nov.18, 1983).

[10] Cf., Letter dated July 8, 1982, from SEC to Savings Association Investment Securities, Inc.

[11] 48 FR 22989 (1983).

> "... to promote competition between bank [thrift] holding companies and all other companies engaged in activities of a financial nature or closely related to banking."12/

In return for specific new holding company powers, S. 1609 would have eliminated present S&L service corporation authority and applied the outside ownership and operating restrictions now governing bank holding companies to thrift holding companies. Essentially, the ownership limitation is that any corporation engaged in a business activity not approved for depository holding companies may not own or control a depository institution. These aspects of the bill have been strongly protested by the thrift industry, and have been ameliorated significantly in the revised bill, S. 2181, which Senator Garn introduced before the end of the 1983 session of Congress.

Under the terms of S. 2181, thrift holding companies are unchanged from their status under current law unless their subsidiary insured institution engages in substantial commercial bank-like activities, defined as more than 25% of its aggregate assets in commercial loans, nonresidential real estate and personal property leased for commercial purposes. With this change and other improvements, the Administration's deregulation initiative, is expected to begin gaining a measure of support within the thrift industry.

The continuing dilemma for the thrift industry is that while many savings institutions could support federal legislation along the lines of the new asset powers contained in S. 1609 and S. 2181, mutual institutions are precluded from participating by virtue of the reliance on the holding company device. As early as December 1982, when negotiations began in earnest with the Administration, Treasury General Counsel Peter J. Wallison informed us that the separate subsidiary concept requires an "upstream" nonbank entity to serve as the parent company, and that an exception could not be made for mutual institutions, many of which are multi-billion dollar entities. Numerous additional meetings with Treasury officials, including Deputy Secretary McNamar, have likewise met with total rejection of the suggestion that mutual depository institutions be permitted to establish "downstream" subsidiaries for purposes of product line expansion.

The Treasury argues that more liberal stock conversion authority is the answer to this problem, but the fact is that the savings bank industry, and to a lesser extent the S&L industry, is likely to remain predominantly mutual for at least the years immediately ahead. Moreover, the Treasury's rationalization that the inequities resulting from the separate subsidiary proposal will be eliminated over time fails to take into account those institutions which, by tradition, management preference, or market conditions will continue to do business as mutual depositories.

In short, the exclusionary nature of the Treasury's separate subsidiary concept as applied to mutual institutions would not only put the thrift industry in the position of being unable to pursue broader powers along with commercial banks, but could actually result in thrift industry opposition to the Treasury's deregulation effort since it would result in commercial bank

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12/ Hearings on Financial Institutions Deregulation Act, before the Comm. on Banking, Housing and Urban Affairs, U. S. Senate, 98th Cong., 1st Sess. (July 18, 1983).

competitors gaining powers denied to the majority of savings banks and savings and loan associations. And while the main focus of the present debate is on securities powers, it is important to bear in mind that the pending proposal extends to the entire range of financial services and could, before the legislative process is completed, be broadened to encompass geographic expansion. Therefore, it is essential, if the thrift industry is to work in tandem with the commercial banking industry and the Administration, that a solution to the separate subsidiary dilemma be found for mutual institutions. On this point, it is instructive to note that while Senator Garn's new bill does not address the exclusion of mutual thrifts, his introductory statement accompanying S. 2181 indicated an awareness and appreciation of the problem:

> "While I attempted to adddress many issues in my revision of S. 1609, there are some which, because of time constraints, I have left to the hearing process. They include the question of bank holding companies for mutual savings banks [and savings and loan associations] which would appear necessary in order for them to qualify for additional powers under the bill, as well as various specific proposals to revise S. 1609 further."

Two inferences may reasonably be drawn from the above-quoted Congressional Record excerpt.13/ First, Senator Garn remains committed to the Treasury-supported format of having all newly authorized activities conducted through a holding company subsidiary. Secondly, the Senate Banking Committee chairman would be sympathetic to incorporating a mutual holding company proposal into the next draft of his legislation if a workable plan can be devised.

III. MUTUAL HOLDING COMPANY STRUCTURE

In attempting to adapt the mutual thrift industry to fit into the Treasury's plans for implementing expanded powers, the closest analogy is actually the mutual fund industry. Mutual funds, or investment companies as they are technically known, have extensive structural and, since they trace their early origins to Boston, even historical similarities to mutual savings banks.14/ More importantly, the founding purpose was identical, i.e., to provide individual investors of modest means an opportunity to obtain higher yields at lower risks by pooling their investments with other individuals.15/

In the early years of their development, mutual funds were internally managed, but more recently the practice, particularly for "open-end" investment companies, has been to rely on external management through a so-called "investment adviser."16/ An investment advisory contract and interlocking directors up to 60 percent under federal law 17/ permit the

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13/ 129 Cong. Rec. 17032 (Nov. 18, 1983).

14/ Mutual Fund Fact Book, 1982, 10.

15/ 1 T. Frankel, The Regulation of Money Management 4-6 (1978).

16/ Id.

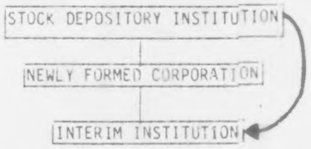
17/ 15 U.S.C. 80a-10(a).

adviser to control any number of funds through means other than stock ownership, while at the same time making stock investments in other lines of business. A good example of the latter capability is the acquisition earlier this year of Lincoln First Bank by Dreyfus Corporation; since then, a number of other investment advisers have followed suit.18/

While it would be possible to pattern a holding company for thrifts along the lines of an investment company/adviser relationship, a number of practical problems intervene, notably the task of blending the requirements of the Investment Advisers Act with the Savings and Loan Holding Company Act. Specific areas of divergence that would have to be reconciled include upstreaming fees/profits, interlocking directorates, transactions between related/affiliated companies, and tax treatment. Similar questions arise in connection with another approach to the problem which would have the director of the mutual thrift establish a separate trust to conduct the new activities for the benefit of the existing depository institution.

Against this background, it appears that the simplest and most straightforward solution would be to adopt the corporate reorganization procedure which both commercial banks and savings institutions now use to form stock holding companies. This technique, which causes a bank or a stock savings institution to become a subsidiary of a holding company, is most frequently referred to as a "phantom" bank merger. The same procedure has more recently come to be described as an "interim" bank or savings institution merger, and the latter term is used for the most part in this memorandum.

Reorganizations of this type are used primarily in two situations. First, when a bank or savings institution desires to form a holding company and, secondly, when an existing holding company seeks to acquire the stock of an independently owned depository institution. The first situation, which is the more relevant one for present purposes, has three basic steps: (1) formation of a wholly-owned subsidiary to become the holding company; (2) chartering of a new bank by the management of the existing institution, and (3) merger of the existing institution into the interim institution. The last step is actually a three-party agreement wherein the existing institution merges with the interim institution, the stock of the existing depository is swapped for the stock of the newly formed corporation, and the newly formed corporation acquires the stock of the resulting depository institution. Portrayed schematically, the process looks as follows:



While the procedure sounds complex, it has been widely used in commercial banking for over twenty years, and just recently the Federal Home Loan Bank Board adopted amendments to its chartering and merger regulations authorizing precisely the same technique.19/ The process has the additional

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18/ See, e.g., Comptroller of the Currency Release NR 83-80 (Nov. 22, 1983).

19/ 48 FR 15,591 (1983).

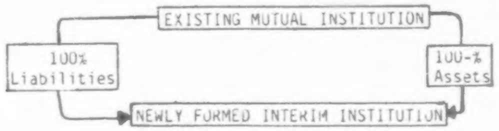
advantage, in dealing with stock institutions, of facilitating the handling of minority shareholders who might not be willing to tender their shares pursuant to the internal reorganization and/or acquisition. One bank commentator has summed up the process as follows:

> "The newly chartered bank never really comes into existence as a separate operating entity -- hence the designation 'phantom' -- and the bank 'resulting' from the merger typically is indistinguishable in name, location and balance sheet from the preexisting bank. In other words, in the real world nothing changes but the ownership of the bank's stock."20/

Adapting this procedure to the mutual context would actually be simpler since only two corporations need be involved as opposed to the three corporate entities involved in the interim merger procedure for stock institutions. The mutual depository institution would form a new subsidiary to hold the interim bank charter and become the resulting entity after the merger has been accomplished. The existing mutual institution would continue as a non-stock corporation with the same directors, by-laws and corporate governance but would no longer be a bank or savings institution. The result of the process is merely to shift the mutual entity one level up.

Mechanics aside, it will also be necessary to devise a procedure that will permit the mutual holding company to be separately capitalized in order to fund expansion into the newly authorized activities, and, over the longer term, to serve as a source of strength to all its operating subsidiaries. To accomplish this, some working capital will have to be retained at the holding company level. Although the interim merger process ordinarily contemplates the purchase and assumption of 100 percent of the assets and liabilities of the existing institution by the interim institution, there does exist another closely analogous corporate financing technique to draw upon here.

This procedure, as permitted by the regulations of the FHLBB,21/ and as recently utilized by several state-chartered savings banks as well, is a simultaneous mutual-to-stock conversion and holding company formation whereby a portion of the proceeds of the public offering are retained at the holding company level. Technically, this is accomplished by selling stock in the holding company rather than the depository institution, and then "down-streaming" most (e.g., 90-95 percent), but not all of the proceeds. The important point for purposes of the present discussion is that precisely the same thing could be done during the merger step in the formation of a mutual holding company. Diagramatically, the transaction would look as follows:



20/ Legal Times of Washington, Nov. 19, 1979.

21/ 12 CFR Sec. 563b.10.

Of course, one byproduct of this process would be a lessening of capital, or net worth ratio, of the insured depository institution, and thus the statutory language included as an appendix to this memorandum limits retained capital to the amount which the institution has in excess of its minimum net worth requirement. Moreover, this step would be subject to the approval of the appropriate federal deposit insurance agency or state guaranty fund as the case may be.

During the course of the negotiations with the Treasury on S. 1609, the question of capitalizing the mutual holding company was specifically discussed. Deputy Secretary McNamar indicated in response to a question on this point that a "one-time capital contribution" by the insured institution to the holding company might be viewed favorably by the Administration as an exception to the general principle underlying S. 1609 that nonbanking subsidiaries have to stand on their own.

IV. MUTUAL HOLDING COMPANY REGULATION

There next arises the question of the appropriate supervisory structure for the mutual savings institution holding company. In order to implement this proposal at the federal level it would be necessary for amendments to be made to both the BHCA and the S&L Holding Company Act. For federally chartered savings banks and S&L associations, the obvious regulator for the mutual holding company would be the Federal Home Loan Bank Board, inasmuch as such institutions are already exempt from the BHCA by virtue of Section 333 of the Garn-St Germain Act.[22]

For holding companies connected with state chartered, FDIC-insured savings banks, a case could be made for having the FDIC act as the principal federal supervisor, which would be consistent with proposals made by past FDIC chairmen that the holding company supervisor should be the same agency that is responsible for supervising the lead bank.[23] Another possibility is the Federal Reserve which has, through a series of recent administrative cases, expanded the definition of a bank for BHCA purposes to encompass certain thrift institutions.[24] On balance, however, it would appear that the FHLBB, as the current regulator of savings and loan and federal savings bank holding companies, would be the most appropriate federal agency in which to place mutual holding companies.

This would have the advantage of consolidating the regulation of all thrift institutions, to the extent that they do business in holding company form, under one agency. Since savings banks have an asset structure more similar to a savings and loan association than a typical money center bank, the operating rules of the S&L Holding Company Act likewise seem more suited to a savings bank than the restriction of the BHCA. In this connection, it is interesting to note that S. 2181, as introduced by Senator Garn, adopts exactly this approach by placing all federally insured savings banks under the Bank Board's jurisdiction.

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[22] Act of Oct. 15, 1982, Pub. L. 97-320; 12 USC 1841(c).

[23] Hearings on S. 332 Before the Senate Committee on Governmental Affairs and Senate Committee on Banking, Housing and Urban Affairs, 96th Cong., 1st Sess., Feb. 28, 1979.

[24] See, e.g.. Application of First Financial Corp. of Bancorporation to acquire Beehive Financial Corp. (68 FR Bull. 253).

Finally, amendments to the federal tax law may also be necessary to ensure that forming a mutual holding company would be a tax-neutral act. Usually this is the case for both bank holding companies and thrifts. Here it may also be noted that the practice for the vast majority of holding companies is to file a consolidated tax return, which has the major advantage of permitting any losses incurred by one subsidiary to offset the income of the bank or other profitable subsidiaries. The same would seem to hold true for mutual holding companies.

CONCLUSION

While the development of a holding company structure for mutual institutions is primarily motivated by legislative necessities, a workable format would also have advantages from a number of other standpoints. It has been suggested, for example, that mergers among mutual institutions could be facilitated by a mutual holding company structure that permits two or more institutions to be operated as separate entities. With the further liberalization of geographic restraints, particularly in the form of legislation authorizing cross-state acquisitions, the mutual holding company holds forth the possibility of providing management with additional flexibility.

The specific proposal described herein is simply a first step, and is designed primarily to move the process forward from theoretical discussion to legislative initiative. Further work and additional refinements, particularly in the tax area, will be necessary.

Appendix A
Rev. 2/7/84

MUTUAL HOLDING COMPANY AMENDMENTS

Section 1. - Section 408a of the National Housing Act (12 USC 1730(a)) is amended to read as follows:

(a)(1)(A) "Insured savings institution" means a Federal savings and loan association, a Federal savings bank, a building and loan, savings and loan or homestead association, a savings bank or cooperative bank, the accounts of which are insured by the Federal Savings and Loan Corporation, the Federal Deposit Insurance Corporation, or by a corporation chartered by a state for the purpose of insuring deposits or accounts [, and shall include a Federal savings bank the deposits of which are insured by the Federal Deposit Insurance Corporation]. For purposes of this subsection the term "insured savings institution" does not include an institution controlled by a comoany registered as a bank holding company under section 1842 of this title. The term "insured institution" is redesignated "insured savings institution" wherever it appears in the text of this section;

(a)(1)(B) "Uninsured savings institution" means any association or bank referred to in subparagraph (A), the accounts of which are not insured by the Federal Savings and Loan Corporation, [except for a Federal savings bank the deposits of which are insured by] the Federal Deposit Insurance Corporation, or by a corporation chartered by a state for the purpose of insuring deposits or accounts;

(a)(1)(C) "Savings [and loan] institution holding company" means any company which directly or indirectly controls an insured institution or controls any other company which is a savings [and loan] institution holding company by virtue of this section. The term "savings and loan holding company" is redesignated "savings institution holding company" wherever it appears in the text of this section;

Section 2 - Section 408a of the National Housing Act is amended by adding the following new paragraph:

(a)(1)(K) "Mutual savings institution holding company" means any savings institution holding company formed by the procedures described in paragraph (o).

(o)(1) Notwithstanding any other provision of law, an insured savings institution operating in mutual form may reorganize so as to become a mutual savings institution holding company by taking the following actions:

(A) Chartering an interim savings institution, the stock of which is to be wholly owned by the mutual institution; and,

(B) Transferring the substantial part of its assets and liabilities, including all its insured liabilities, to the interim savings institution. Persons having ownership rights in the mutual institution pursuant to section 1464(5)(b)(1)(B) of this title or state law shall, pursuant to regulation promulgated by the Board, have the same ownership rights with respect to the mutual savings institution holding company.

(o)(2) A reorganization plan authorized under this paragraph must be approved by a majority of the board of directors of the mutual savings institution. In the case of an institution in which holders of accounts and obligors exercise voting rights, the plan of reorganization shall also be submitted for approval by a majority of such individuals at a meeting to be held at the call of the directors in accordance with the procedures prescribed by the institution's charter and bylaws.

(o)(3) - An insured institution seeking to establish a holding company pursuant hereto shall provide the Federal Home Loan Bank Board with sixty days prior written notice.

(A) The notice shall contain such relevant information as the Board shall require by regulation or by specific request in connection with any particular notice.

(B) Unless the Board within such sixty-day notice period disapproves the proposed holding company formation, or extends for another thirty days the period during which such disapproval may issue, the insured institution providing such notice may proceed with the transaction.

(C) The Board may disapprove any proposed investment only if --

(i) such disapproval is necessary to prevent unsafe or unsound practices;

(ii) the financial or management resources of the insured institution involved warrant disapproval; or

(iii) the insured institution fails to furnish the information required under clause (A).

(D) In connection with the transaction described in subparagraph (o)(1), an insured savings institution may, subject to the approval of the Board, retain capital assets at the holding company level to the extent that such capital exceeds adequate reserves as prescribed pursuant to section 1726(b) of this title or the comparable provisions of State or Federal law.

(o)(4) In addition to the exercise of its other lawful powers, a corporation organized as a mutual savings institution holding company may:

(A) Invest in the stock of an insured savings institution or a savings institution holding company;

(B) Acquire a mutual savings institution through merger into an insured savings institution subsidiary or an interim savings institution subsidiary;

(C) Merge with another mutual savings institution holding company; and

(D) Invest in a corporation the capital stock of which is available for purchase by a savings institution by Federal law or by the law of such State where the subsidiary savings institution or institutions have their home office.

(o)(5) Unless the context otherwise requires, a holding company established by this subsection shall be subject to the requirements of section 1730a regarding regulation of holding companies.

New Language Underlined

[Language to be deleted in brackets]

Appendix B

MUTUAL HOLDING COMPANY AMENDMENTS
Section-by-Section Analysis

The purpose of these amendments is to provide a mechanism for mutual institutions to form a holding company. In order to permit mutual institutions to be full participants in the Administration-sponsored legislation to expand the powers of bank and thrift holding companies, it is necessary to provide a holding company structure for institutions not choosing to make a public stock offering.

These amendments accomplish this purpose by permitting the mutual institution to create a wholly-owned subsidiary corporation to function as the insured depository institution while the parent holding company, which remains mutual, carries out the new insurance, brokerage, real estate and securities activities through other subsidiary corporations. Terminology changes are also made to reflect the growing number of savings institutions no longer using the term "Loan" in their title.

Section 1. (a)(1)(A) expands the Savings and Loan Holding Company Act to include any savings bank the deposits of which are insured by the FDIC or a state insurance fund. Institutions covered by the Bank Holding Company Act are specifically excluded. Finally, the term "insured institution" is redesignated "insured savings institution" in order to be more descriptive.

(a)(1)(B) makes a conforming change to the definition of an "uninsured institution".

(a)(1)(C) redesignates the term "savings and loan holding company" to read "savings institution holding company", since the Act now covers both savings banks and savings and loan associations coverting to savings banks.

Section 2. (a)(1)(K) adds a new term to the definitions section of the Act to identify "mutual savings institution holding company" that is created pursuant to the new authority included in paragraph (o)(1).

(o)(1) provides a two-step process for mutual institutions to reorganize into a holding company. The process is patterned after the FHLBB's existing regulations permitting an insured institution, whether stock or mutual, to convert to stock holding company structure by merging the insured depository with a newly created interim or so-called "phantom" institution. This process is already widely used in commercial banking.

The first step, as provided in clause A, is chartering of an interim savings institution the stock of which is not public and which is to be held solely by the mutual institution. This is a simplified process under the Board's present regulations in that this charter can be granted without meeting the usual prerequisites such as the minimum capital and federal insurance coverage. The next, and final step as described in Clause B, is the bulk transfer of the existing assets and liabilities of the insured depository institution into the interim institution with the result that the mutual institution, which no longer holds a savings institution charter, nevertheless continues as a depository holding company with certain retained assets as working capital.

(o)(1)(C) recognizes the voting and other ownership rights which individuals now have in federal or state mutual savings and loan associations, and provides that these ownership rights shall continue pro rata with respect to the mutual savings institution holding company.

(o)(2) provides that the plan of reorganization must be approved by the mutual institution's board of directors. In the case of those institutions with shareholder voting, approval by accountholders is also required.

(o)(3) provides an expedited procedure for mutual institutions to obtain FHLBB approval to form a holding company. Rather than require affirmative prior approval, this procedure is modeled after the current provisions of S. 1609 dealing with "nonbanking activities" that permits an institution to undertake the activity after filing a 60-day notice unless the regulatory agency specifically disapproves the proposed undertaking. A similar approach was adopted as part of the Bank Export Services Act of 1982 (Pub. Law 97-290).

(o)(3)(D) permits a mutual institution to retain certain assets and corporate liabilities, other than insured deposits, at the holding company level in order to provide working capital for the holding company. These assets represent a one-time infusion of capital, and could only be retained to the extent that the institution possesses capital in excess of minimum net worth requirements and obtains FHLBB permission to do so.

(o)(4)(A) permits a mutual holding company to acquire a stock savings institution or a stock savings institution holding company.

(o)(4)(B) permits a mutual holding company to acquire another institution formerly organized as a mutual through a direct merger into an insured subsidiary or merger through the interim savings institution procedure.

(o)(4)(C) permits a mutual holding company to merge with another mutual savings institution holding company.

(o)(4)(D) permits a mutual holding company to invest directly in a service corporation that would be a permissible investment under federal or state law for an insured savings institution.

(o)(5) provides that a mutual holding company is subject to the same requirements applicable under this Act to stock holding companies.

Appendix C

STUDY GROUP ON HOLDING COMPANY FORMATION

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The CHAIRMAN. Thank you, Mr. Cooke.
Mr. Muse.

STATEMENT OF WILLIAM B. MUSE, JR., PRESIDENT, IMPERIAL SAVINGS & LOAN, MARTINSVILLE, VA.; CHAIRMAN, AMERICAN LEAGUE OF FINANCIAL INSTITUTIONS

Mr. MUSE. Mr. Chairman, I am very happy to be here again before this committee.

[The complete statement follows:]

Mr. Chairman, my name is William B. Muse, Jr. I am President of Imperial Savings and Loan Association of Martinsville, Virginia. I am also Chairman of the American League of Financial Institutions, formerly the American Savings and Loan League. Our membership is made up of savings and loans/savings banks that are controlled or owned by Blacks, Hispanics, Asian-Americans, other minority groups and women.

The American League appreciates the opportunity to comment upon S. 2181, the Financial Services Competitive Equity Act and S. 2134, the Depository Institutions Holding Company Act Amendments of 1983.

While the stated purpose of S. 2181 is to provide a comprehensive Federal statutory framework for the regulation of activities of bank holding companies, unitary savings and loan holding companies and service corporation statutes, we question the timing of such sweeping legislation. It has been scarcely one year since the enactment of the Garn-St Germain Depository Institutions Act of 1982, which was hailed as representing a competitive emancipation from the laws and regulations that artificially constrained investments of thrifts. Now we are confronted with additional changes that hint towards "re-regulation" instead of the "deregulation" that Congress and the Administration have been striving to achieve. S. 2181 contains provisions that are probably too much for us to digest at this time.

Since my last testimony before this Committee in May of 1983, there have been a couple of casualties in our membership. Overall, however, we have survived and have moved toward profitability along with the rest of the industry. Those of our member institutions that took advantage of liberalized provisions for conversion to the stock form of ownership have enjoyed even greater profitability than non-minority S&Ls. Overall, the assets of minority savings and loan associations and savings banks have increased by almost $1 billion, so that now the 75 institutions in the United States have assets in excess of $3.8 billion. This growth is largely due to the exercise of the expanded powers under Garn-St Germain. For this reason, we oppose any legislative change at this time that has the effect of penalizing thrifts that (1) didn't take advantage of the power to organize a holding company, or (2) have not decided to exercise their authority to organize a service corporation as of July 1, 1983; or (3) operate a thrift service corporation as a mutual and subsequently convert to the stock form after the July 1, 1983 date. It seems patently unfair to place a significant segment of our industry at such a competitive disadvantage merely because they are not part of a multiple S&L holding company or chose not to avail themselves of the opportunity to establish a unitary S&L holding company provided under the Garn-St Germain Act of 1982.

Mr. Chairman and members of the Committee, there is no question but what there needs to be a clarification of the definition of banks and thrifts. There also needs to be a streamlining in the procedure for holding company applications and some equity between the powers of a multiple S&L holding company and a unitary S&L holding company. At this time, however, we believe that there are too many controversial issues pertaining to interstate banking, bank entry into the securities business, for example, that require further detailed analysis and study. We do not believe that sufficient attention has been given to the effect of these provisions on those thrifts that have little incentive for continuing to be home mortgage lenders.

On the subject of non-bank banks, here again S. 2181 appears to favor those larger financial institutions which have taken advantage of a loophole in the law Not only are their prior activities legitimized under this bill, but the specialized category of a "consumer bank" would be created. These consumer banks would be exempt from the Bank Holding Company Act, as well as from oversight by the Federal Reserve. It might seem that the unlimited real estate investment authority of the consumer bank might be an option for the small or minority S&L. Closer examination reveals, however, that this new type of financial institution does not enjoy FHLBank membership and service corporation authorities, and therefore would not be a viable option for anything other than the non-bank banks. We would oppose the authorization of such banks because concentration of powers into larger institutions tends to be anti-competitive.

There are two provisions in S. 2181 that we support. The first is Title IV that allows financial instutitions to be paid monthly interest on reserves held at the Federal Reserve against money market deposit accounts, super NOW accounts and other transaction accounts that might be authorized. Since thrifts have come under the regulation of the Fed since 1980, we have a keen interest in this issue.

Title VIII of S. 2181 would allow thrifts to pay interest on demand deposits, and is a provision that we strongly endorse. There is no apparent reason for limiting S&Ls to providing interest-bearing NOW accounts for individuals and nonprofits. In fact, such a limitation places thrifts at a disadvantage to commercial banks which can maintain demand accounts without the payment of interest. Allowing demand accounts to be opened for business customers at a thrift institution expands the range of services to these clients. As we all know, loans create deposits -- and where a thrift creates a business relationship with a small businessman, for example, it now will be able to maintain the checking account for that business as well.

This concludes our comments on the pending legislation. I would be pleased to answer any questions you might have.

The **Chairman**. Thank you, Mr. Muse.

Mr. Zellars, last week we had representatives of the banking industry before the committee testifying on these same bills and we heard bank executives complain that the Bank Holding Company Act has rather cumbersome regulatory burdens that applies only to banks and that there's no real justification for treating some depository institutions different from others.

Of course, you are arguing against placing thrift holding companies under the regulatory umbrella of the Federal Reserve.

Do the bankers have any point at all when they talk about trying to treat like services the same and regulate them the same?

Mr. **Zellars**. Of course, our opinion is that the Federal Home Loan Bank Board has been an able regulator insofar as our business is concerned and that any regulations applicable to us should come from the Federal Home Loan Bank, not the Federal Reserve.

PRINCIPLE OF EQUITY TREATMENT

The **Chairman**. Mr. Cooke, why shouldn't bank and multiple thrift holding companies be regulated under basically the same or similar standards?

Mr. **Cooke**. I would suggest that they should, Senator, but perhaps the way to do it is to liberalize and streamline the regulation and provision to which banks are subject under the Bank Holding Company Act rather than constrict, reduce, and perhaps further complicate the restrictions that are applicable to savings and loan holding companies. In other words, move up rather to a higher level rather than move things down to a lower level. But the principle of equity of treatment, Senator, I think is one you can't quarrel with.

The **Chairman**. Well, as I've said many times and it bothers the Federal Reserve, first of all, I don't think the Fed needs to be in the regulatory business for anybody when we start talking about changing regulation and who regulates what and I have long supported the idea of exploring very carefully regulation by function, and you pointed out in your testimony that it is correct to decide who's going to do what before we look at the Vice President's report or look at the regulatory questions, and I think that is the only sensible way we can go. Until we know who is going to be doing what, I don't know how you decide who regulates that.

But what I'm driving at here is more of a principle that everybody seems to agree that there is overregulation, too many agencies involved. We can all use the example of the Tennessee Bank situation where there were 11 different regulatory agencies. But everybody almost universally continues to say in principle we agree with that; it ought to be reduced; we ought to eliminate overlap and duplication, but we want to keep our regulator; and yet we say the principle is correct that we ought to be regulated under basically similar standards.

So how do we resolve that? How do we ever resolve who regulates what if nobody wants to give up their personal regulator but we all agree on the general principle? Do we ever get to regulation by function so that if you're in the securities business that maybe the SEC regulates a thrift, a bank, a securities firm, so they are all regulated the same for that service; or a securities firm wants to be in the banking business so that they're regulated by a bank regulator?

You see, I'm having a problem anybody of the three can answer, but everybody agrees in general principle but nobody agrees on any specific so that we go on with this multiplicity of regulatory agencies.

Mr. **Zellars**. Well, you've got a big group out there that has no regulator at all. The question of how to bring them all under a single umbrella is very difficult to answer.

The **Chairman**. Well, I'm not talking about a single. I don't favor one super-regulatory agency, never have. I'm talking about going toward regulation by function. The people are doing the same service. If banks and savings and loans eventually get into the money market funds, then does it make sense to have the SEC regulate securities firms; the Fed regulate bank holding companies; the Federal Home Loan Bank Board regulate savings and loan institutions with different regulations, reserve requirements, and all sorts of different requirements for exactly the same type of product? Any volunteers?

Mr. **Muse**. Mr. Chairman, I think that we are at an unusual point in the time of history with all the great changes that have happened in the last 5 years. I think whoever can answer your question is a rather wise person.

The **Chairman**. Well, that's what we're trying to do, is find some wise people to try to answer some of these questions because if you think the market has changed in the last 5 years, wait and see what's going to happen in the next 5 years. That is the whole purpose of me pushing ahead to try and rationalize and come up with some wise decisions. No one person has the answers. Certainly I don't. Some other people think they do. They don't. I'm willing to admit that I don't.

But simply, how long can we procrastinate before we start answering some of these questions? That marketplace is not going to wait. It hasn't and it is speeding up its rate of change very rapidly, but I guess I'm not going to get an answer except that it's going to take some wise person to decide, or group of persons, but I'm trying to focus on the nature of the difficulty of resolving these problems if everybody agrees in general principle but nobody agrees on some specifics.

If we are able to resolve some of the problems of powers this year, then we've got to move on to how those are being regulated so that Government is not regulating by laxity and is not giving some institutions unfair competitive advantage over others.

You notice I have very carefully avoided using the words "level playing field," because I'm so tired of it I dance all around it, but that's essentially what I'm trying to drive at. But you have no specific recommendations today then, other than that you want to stay with the Federal Home Loan Bank Board; right?

Mr. **Cooke**. Well, if I may comment further, Mr. Chairman, I do so with hesitancy because I don't want to be considered as putting myself forward as a wise man. I think the tendency for an institution to have its favorite regulator is a perfectly understandable tendency. It would seem to me that one way to get from here to there, from where we are to a more rational situation that reflects the principle I think we all endorse, namely, equity of treatment and regulation by function, is to have the approach of the different regulators at more closely the same level. This would at least be a step toward true equity as well as regulation by function.

The **Chairman**. I understand.

Mr. **Cooke**. It seems to me that this would be an intermediate step which would get us over some of the practical problems that are resistant to change.

The **Chairman**. Maybe you could elaborate just a little bit more on—back in your testimony you make a distinction between an asset test to determine who regulates an institution and an asset test to determine what powers that institution can be granted.

Mr. **Cooke**. Yes. It just seems to us that those two topics can properly be viewed somewhat separately. The question posed by this bill is: Which institutions should be regulated as commercial banks? The other question, which arises more in connection with the Bush task group is: Which institutions should be eligible for membership in the FHLBB? That is simply all we are trying to suggest by those comments.

CONSUMER BANKS UNJUSTIFIED

The **Chairman**. Mr. Zellars, you argue that consumer banks are unjustified. Mr. Muse does as well, and it would contribute to concentration. And you specifically state that it's an unjustified invention as a type of bank, and consumer credit is insufficiently important policy objective for consumer banks to be allowed unlimited holding company objectives.

Why should thrifts alone be allowed such privileges?

Mr. **Zellars**. Well, I don't think that thrifts alone are allowed that privilege. I think it's available to the whole nonbank banking community right now. The consumer bank issue is really a new invention that is coming into play. We are having a difficult time trying to define what a bank is, and now we're throwing a new player in the game. I think the consumer bank function is a function that is being met by the commercial banks as well as the thrifts today.

The **Chairman**. Well, are consumer banks really a new invention? They're certainly not in my State. They're not called consumer banks, but I don't think it's a new invention. We have a different name for them.

Mr. **Zellars**. It's subject to nomenclature; you're entirely correct. In some States it's a new name that has been created for an old type of institution. Their functions are still being performed today by the commercial banks as well as the thrifts.

The **Chairman**. I want to make that clear, that it's not a new institution any more than Mr. Cooke and who he's representing today—they have a name change, but two well-known organizations have merged under a new name. And consumer bank—I'm a little bit puzzled with that. A lot of people are saying you're creating a new institution. There's a new name in the bill for institutions that have been around for a long, long time.

Senator Hecht.

Senator HECHT. Thank you, Mr. Chairman.

Mr. Zellars, in your statement you mention real estate investment, construction participation to 5 percent and you don't want to see that changed downward at all.

A lot of the bankers I have been talking to feel they want to get into this and get 10 percent of their capital into this. How do you feel about that?

Mr. ZELLARS. Well, as far as I know, they are in it in a pretty big way today.

Senator HECHT. Not all banks.

Mr. ZELLARS. The banks in our area are in construction lending and real estate development today in a pretty big way.

Senator HECHT. I mean for participation, the 5 percent you are allowed of your capital is what I'm talking about.

Mr. ZELLARS. That 5 percent that we testified about has to do with the multiple savings and loan holding companies.

Senator HECHT. Yes.

Mr. ZELLARS. The problem is that limiting this activity to 5 percent of the capital of the parent or the holding company really is a cutback. A limit of 5 percent of the capital really does not give the multiple savings and loan holding company sufficient room to maneuver in that area. Five percent of the capital of a $2 billion company might very well be $7.5 million, making the unlikely assumption that the holding company has $150 million in capital.

Senator HECHT. But this has given you one tool to survive in the last year and come up. I know I have spoken to many savings and loan people and they feel this is very important in their industry.

Mr. ZELLARS. I have no problem with the banks being involved in it.

Senator HECHT. How do you feel about it, Mr. Cooke?

Mr. COOKE. I have no problems with that.

Senator HECHT. You feel you can compete on that basis?

Mr. COOKE. We're quite willing to try, Senator.

Senator HECHT. Mr. Cooke, it's been said that the last two major banking efforts in 1980 and 1982 were sweetheart bills for the thrifts. Have we had enough time to fully assess the impact and benefits of these bills on the industry?

Mr. COOKE. No, I don't think we have, Senator. They were both very far-reaching bills. It's difficult just from an operational standpoint to take full advantage of some of the powers immediately, so that I do think that some additional time is required before we can assess properly the full impact of those bills on savings institutions.

Senator HECHT. Is there a dire need for us to take additional steps at this time?

Mr. COOKE. In terms of expanding powers, I would not say there is a dire need, Senator. On the other hand, as the chairman indicates, the marketplace is changing very rapidly so I think there are pressures from the marketplace that require some legislative attention.

Senator HECHT. Do you think the marketplace will work out over a period of time without any legislation?

Mr. COOKE. Yes, it will work out, but it may work out in a way that seriously disadvantages some of the current players.

Senator **Hecht**. OK. Mr. Muse, I'd like to compliment you on the brevity and the thoughtfulness of your statement. In your opinion, has your industry felt the full impact of the legislative changes brought forth in the Garn-St Germain Act?

Mr. **Muse**. No, not as yet, Senator.

Senator **Hecht**. Are there still some problems that could reemerge or are the savings and loans out of danger?

Mr. **Muse**. I didn't hear the last part.

Senator **Hecht**. Are there still some problems that could reemerge or are the savings and loans out of danger?

Mr. **Muse**. I think that we're not in danger, but I think we recognize a lot of things that weren't recognized 2 or 3 years ago and that we have certain tools if we implement them and use them correctly and properly that we can continue to show greater strength. But for some of the same reasons that have been alluded to in this meeting this morning, it's a very new ball game in many respects. The playing rules have changed considerably. The scope of the game is much larger and adjusting the—putting the human resources and the material resources in place to deal with these various aspects continues to be something that we have to be concerned about.

Senator **Hecht**. Do you see any pressing need to proceed with major legislation at this time?

BANKING COMMITTEE NEEDS TO MAINTAIN OVERSIGHT ROLE

Mr. **Muse**. Major legislation is questionable, but certainly I think that the committee is on target to be concerned and to have some concerns and to be monitoring more or less or to be maintaining an oversight role. I think it's logical for us to expect or anticipate or have the atmosphere that we're in now because you can't simply go through all the changes that have been propounded in the last 3 or 4 years without a need for continuing review and concern and doing the things that we're trying to do this morning.

Senator **Hecht**. In your testimony you said S. 2181 contains provisions that are probably too much for us to digest at this time. Maybe some people have digested it and that's the reason everybody is showing up for these hearings.

Mr. Zellars, in your statement you suggest that an asset composition test properly crafted assures that regulation will reflect real world behavior of institutions and not the hypothetical possibilities open to them. Yet Mr. Muse and Mr. Cooke suggest that this approach is a step backwards toward re-regulation. Could you comment on that?

Mr. **Zellars**. Well, what I'm really saying is that the asset composition test, is a test of what these institutions are actually doing today. The commercial lending test, tests on what we are not doing today. We feel that with certain modifications the asset test would accomplish the desires of these bills.

Senator **Hecht**. Well, Mr. Cooke, with the experiences of your industry in 1981 and 1982, how can we be certain that thrifts will stay focused on housing finance without an assets test of some kind?

Mr. COOKE. I think, as I tried to indicate in my testimony, Senator, we have to recognize the very radically changed nature of the mortgage market. An institution could be the dominant home lender in its locality, yet add little or nothing to its mortgage portfolio by participating very actively in the secondary market which, given the new kind of mortgage market that we have today, is a perfectly legitimate way to meet the housing needs of the community.

I would also submit that a number of savings and loan associations and savings banks play a very important role in meeting the community needs of their service area by providing mortgage and other financing for nursing homes, for shopping centers, for factories, for elements of the infrastructure and that type of participation in community development, of course, is not given any credit in an asset test that focuses exclusively, as some have suggested, on residential mortgage lending.

Senator HECHT. Thank you.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator Hecht.

Let me pursue some of the questions that Senator Hecht was asking. He asked one question about whether there was a dire need for legislation this year, and I would have to agree with the statement that if you use the term "dire," at least as I would define that, there is probably not a dire need.

Also, the question about would the marketplace work it out, oh, yes, the marketplace will work it out. It has been doing so. But I'm a little bit puzzled at your testimony compared to some other witnesses.

If we take out the word "dire" or "critical" or words of that nature, most everybody else who has testified has indicated that the marketplace is moving so rapidly that, yes, there is need for legislation, and I hear some caution, particularly from Mr. Muse, that we need time to digest this.

How fast can you digest the marketplace? Just in 1981, when I became chairman of this committee, we had depository institutions in the country, both banks and savings and loans, particularly savings and loans, on their backs, literally, with more mergers in 1982 than any Federal Home Loan Bank Board had handled in the entire history of the Federal Home Loan Bank Board. And yet I was hearing testimony in 1981 and 1982 sending the same cautions that, well, let's consider this very carefully.

Gentlemen, if the marketplace were standing still, I could go along with that. There are a lot of things to do in the Senate that I don't have to work 23 hours a day on trying to resolve some of these policies.

The other answer to no legislation is moratorium. Do any one of the three of you favor a moratorium, stop the world we want to get off?

Mr. COOKE. We are strongly opposed to moratorium legislation, Senator.

The CHAIRMAN. Mr. Zellars.

Mr. ZELLARS. We are opposed to that.

The CHAIRMAN. Mr. Muse.

Mr. MUSE. Opposed.

The CHAIRMAN. That's why I'm a little bit puzzled. You don't want to stop it. You're opposed to a moratorium because of the inequities that that creates, and what I'm trying to establish here is that I'm afraid from your testimony and the answers, even though I thought I knew how you felt, that those who want to be more cautious, I can see it being taken out of the testimony and some of my colleagues saying, "Well, let's just relax for a while. Garn-St Germain has only been in effect for 1½ years. Let's just relax and not do anything."

Well, that would be fine if the marketplace would stop and the State legislatures would stop, but they won't. You're going to have more South Dakotas. You're going to have more Delawares. You're going to have more interstate compacts because the State legislatures in a lot of ways are ahead of us.

So let me ask one more question. What happens to your institutions if Congress does not develop a national policy to what is going on in the marketplace? Mr. Zellars, what happens to your institutions if no moratorium and we—just let's think about these very carefully and thoughtfully for another 3 or 4 years, as we have for the last 9 years at least while I've been here—we've been considering every one of these issues very thoughtfully? They have grown more difficult and important as we continue to procrastinate, but assuming we do nothing, no bill, no moratorium?

Mr. ZELLARS. Well, you're certainly going to have some action on the part of the regulatory authorities, perhaps on the part of the State legislatures.

To me, I think this is an issue that the Congress had better address rather than leaving it to the devices of the various regulatory authorities.

NATIONAL POLICY SHOULD BE SET THIS YEAR

The CHAIRMAN. But then, to get back to not prejudging any particular issues—and we have your testimony on that and I've said it at least a million and a half times—I have no great pride of authorship and the purpose of the hearings is to receive testimony to try to come up with a consensus bill. So without regard to particular provisions then, you would agree that it is important to move ahead with trying to set a national policy this year?

Mr. ZELLARS. Yes, sir; I do.

The CHAIRMAN. Mr. Cooke.

Mr. COOKE. I would certainly agree, Mr. Chairman, and I may have placed undue emphasis on Senator Hecht's use of the word dire. I certainly think that we have to move.

The CHAIRMAN. I agree with your answer on dire.

Mr. COOKE. We certainly have to move ahead. The Garn-St Germain legislation has been of inestimable value to savings institutions. We have not had time yet to fully capitalize on the broader authorities granted by Garn-St Germain, but there's no question that it's been of inestimable value and we certainly appreciate your strong and continuing leadership in that whole effort. Similarly, we are grateful to you for fashioning a bill, S. 2181, which at least provides a basis for attempting to come to grips with some of these very complicated issues that do need addressing by Congress and where some national policy is needed.

I think that your efforts and the committee's efforts have to be welcomed.

The CHAIRMAN. There is no doubt that there is a base for argument, discussion, and disagreement and fighting.

Mr. Muse, again you recommend some caution and made a statement that I would fully agree with, that you haven't yet been able to digest what has already taken place and I understand that fully. Would it be easier to digest a national policy that you could count on or digest what is taking place in the marketplace?

Mr. MUSE. Well, I think that certainly we need a national policy, but I think there are some other aspects of changes that we are going through that are even bigger than our different association. We are finding that we are having to recruit a different type of personnel, people of greater skills, and some of those things. No one wants to sit around and do nothing, and we are not doing nothing. We are simply trying to get the human and material resources that we need to cope with the opportunities of the marketplace. There's no more 3-6-3's, to talk about it in this business. We are strictly 18-hour a day people now and we must be productive and we must get support I think all along the line from the regulators. They are conducting schools. They are upgrading their pay scales. They are recruiting people with greater skills and I think that those sorts of things that probably concern us, not trying to turn the clock back or anything like that. We're simply trying to get the necessary things that it takes to effectively deal with the risk of the marketplace, and I certainly agree that the risks are different than they were some years ago.

The CHAIRMAN. I understand completely what you're saying and I would agree with the change coming so rapidly. It used to be the institutions went on year after year with minor changes and you went to work every morning and knew exactly how the business was going to operate that day and didn't have to face all these new challenges. I understand that.

My point is, which is more difficult, to try and fashion a national policy so you know what you're dealing with or to deal with the changes and the abberations that are occurring in the marketplace? My opinion is simply that however we eventually resolve the so-called national policy, that that would be easier to digest than a State legislature doing this here and another one doing something there and regional compacts and another South Dakota situation with the insurance. Now New York State has a new recommendation for their legislature. And then you've got regulators acting and courts saying you don't have the legislative authority to do that, as happened to the Fed in the case, interestingly enough, originated in Utah. I had nothing to do with it at all.

But that's what I'm trying to point out very strongly over and over again, not only here today but across the country; that is, my role is not to dictate a national policy but to try and make people recognize what is happening in the marketplace and how difficult that is for businessmen to make decisions. It seems to me that is much more difficult to digest, to use your words, than to try and face some legislation.

Under normal circumstances, I would agree, if you pass a bill of major proportions you see what happens, you analyze it, and I wish that were the normal process. I don't think we have that kind of time to sit back for 4 or 5 years and analyze. I not only don't think, I know we don't. Technology is part of it, electronic funds transfer.

Well, let me sum up by just asking you one more question, without regard to differences of opinion on specifics of the legislation, would all three of you agree that a national policy is needed as soon as it's possible to do so?

Mr. **Zellars**. Yes, sir.

Mr. **Muse**. Yes.

Mr. **Cooke**. Yes.

The **Chairman**. I would certainly encourage all of you to remain in the process, offer your constructive criticisms, your constructive suggestions, and your specific analysis of provisions of these bills, and if you have additional provisions that are not in it you wish to suggest the committee would certainly consider those as we will from all segments of the financial services industry as they appear before the committee to testify.

Thank you very much for your willingness to be here today.

Our next panel is Mr. M. R. Mandy Hellie, president, University of Colorado Federal Credit Union; on behalf of the Credit Union National Association; and Mr. John J. Hutchinson, manager, Hamilton Standard Federal Credit Union, Windsor Locks, Conn.; president, National Association of Federal Credit Unions.

Gentlemen, we are happy to have you before us and, Mr. Hellie, if you'd like to begin.

STATEMENT OF M. R. (MANDY) HELLIE, PRESIDENT, UNIVERSITY OF COLORADO FEDERAL CREDIT UNION; ON BEHALF OF CREDIT UNION NATIONAL ASSOCIATION

Mr. **Hellie**. Mr. Chairman and members of the Banking Committee, my name is Mandy Hellie. I am president of the University of Colorado Federal Credit Union. I am testifying today on behalf of the Credit Union National Association or CUNA. CUNA, the credit union movement's leading trade group, represents more than 19,000 Federal and State-chartered credit unions which serve more than 50 million borrowers and savers.

A week ago we fully expected that the testimony we would present today would be straightforward. We had hoped to express our unconditional support for S. 2121, the Share Insurance Fund capitalization bill, as well as for a limited number of relatively minor credit union amendments in the omnibus banking package before this committee.

CREDIT UNIONS MAY LOSE TAX-EXEMPT STATUS

However, our positions on these measures are no longer clear cut, because late last week we learned that the Senate Finance Committee is scheduled to meet today to discuss a proposal to eliminate credit unions 50-year-old Federal income tax exemption.

We have a very limited knowledge of the specifics of the proposal. The actual language, if any exists, has not been the subject of hearings. Neither credit unions nor their Federal regulator have been consulted, formally or informally, as to its details. We do not know if the Finance Committee intends to tax credit unions based on size or some other factor. We don't know if the committee plans to take into account such credit union requirements as statutory reserves or whether there would be an allowance for bad debts similar to the one applicable to savings and loan associations. In short, we fear that Congress may enact legislation without benefit of valuable public input, in order to avoid evaluating any plan on its merits. I submit, Mr. Chairman, that this is bad public policy.

Last March when we appeared before the Finance Committee to defend our tax-exempt status, the committee had no specific plan before it. We reminded the committee then that credit unions are nonprofit, member-owned cooperatives. We discussed that although some credit unions are very large—73 have more than $100 million in assets—the majority are small. Over half of the 19,240 credit unions in the United States have less than $1 million in assets.

Whether large or small, credit unions continue to place people before profits. In good times and bad, credit unions meet their members' needs—arranging loans for the jobless, deferring payments, even carrying payments until a member is back at work.

This tradition of people helping people is practiced at all levels of the movement. We have developed a network of credit unions to help other credit unions with their liquidity needs and to provide investment options. We try to deal with State and Federal regulatory agencies with the same goal of self-help in mind. CUNA is extremely concerned about any proposal to tax credit unions because we fear it would undermine this tradition. More immediately, taxation threatens to undermine credit union support for S. 2121, the bill to capitalize the share insurance fund. Senator Garn introduced this legislation in November at the request of the National Credit Union Administration. The bill would require each federally insured credit union to deposit 1 percent of its insured shares with the NCUA-administered share insurance fund. The fund insures credit union accounts for up to $100,000. Because the equity of the 13-year-old fund has not reached the 1-percent standard set by Congress, CUNA's executive committee, after lengthy consultation with credit unions, voted unanimously this month to endorse the capitalization plan embodied in S. 2121.

We believe this legislation offers the best solution to bolstering the fund and placing it on a par with the equity levels of the other deposit insurance funds—the FDIC and the FSLIC. This self-funding, self-help legislation will eliminate the need for credit unions to pay a second premium each year to the fund. Federally insured credit unions have had to make special payments for the last 2 years, and they found them particularly burdensome because they were not able to budget for them.

In formulating our position in support of a deposit of 1 percent of the insured shares of federally insured credit unions—an amount equal to about $850 million—CUNA did not factor in the possibility that credit unions would also become subject to Federal income taxes.

CREDIT UNIONS WILL RECONSIDER VOLUNTEER INITIATIVE

We believe that credit unions will reconsider this volunteer initiative if it seems they will also lose their tax-exempt status. A credit union manager who finds his institution subject to Federal income tax may very well balk at any proposal to shift additional dollars from the credit union to the Government. He or she may question why any additional burden should be undertaken to increase the equity of the fund when Congress has pledged that the fund is backed by the "full faith and credit of the United States."

As I mentioned, the capitalization plan calls on credit unions to transfer $850 million to the Federal Government. This contribution would continue to grow as credit unions grow, and our savings increased by nearly 20 percent in 1983. Even though this money will be used to strengthen the share insurance fund, it would reduce the Federal deficit by an equal amount. The credit union movement has already voluntarily transferred $200 million this year to capitalize the central liquidity facility, also administered by NCUA. This transfer also translates into a $200 million reduction in the deficit.

The Finance Committee estimates its proposal to subject credit unions to Federal income tax will raise about $300 million over 3 years. The arithmetic of this equation should, we hope, encourage Congress to conclude that taxation of credit unions would not advance its commendable efforts to reduce the Federal budget deficit. On the other hand, if Congress presses the taxation proposal, then credit unions must weigh its effect on their balance sheet before endorsing the transfer of 1 percent of insured shares to the share insurance fund.

If Congress rapidly concludes that taxation of credit unions will be counterproductive, then we will urge the Banking Committee to move quickly to report out S. 2121 as separate legislation so that Congress can enact the plan to capitalize the share insurance fund by mid-year.

My written statement highlights those sections of S. 2181 of interest to credit unions. Title II contains seven relatively minor amendments to the Federal Credit Union Act, none of which will change the traditional consumer orientation of credit unions. However, if Congress enacts legislation to tax credit unions, credit unions will have to reevaluate their role in the financial sector and determine if radical changes are needed. Since we do not know the details of the proposals to tax credit unions, it is difficult to predict what changes may be needed. We hope we will not have to ask this committee to undertake a major rewrite of the powers and structure of credit unions, because we like what we do for our consumer members. We help cure their financial problems and our own as well.

Thank you, Mr. Chairman.

[The complete statement follows:]

STATEMENT OF
M.R. (MANDY) HELLIE
ON BEHALF OF THE
CREDIT UNION NATIONAL ASSOCIATION, INC.
BEFORE THE SENATE BANKING COMMITTEE
ON
S. 2121, CAPITALIZATION OF THE SHARE INSURANCE FUND
S.2181, OMNIBUS BANKING AMENDMENTS
AND OTHER BILLS AFFECTING CREDIT UNIONS

FEBRUARY 28, 1984

Mr. Chairman and members of the Committee on Banking, Housing and Urban Affairs, my name is M. R. (Mandy) Hellie. I am President of the University of Colorado Federal Credit Union and appear here today representing the Credit Union National Association, Inc. (CUNA). CUNA is an association of credit union leagues in each state, the District of Columbia, and Puerto Rico. Through these leagues, CUNA represents approximately 19,000 federally and state chartered credit unions which serve more than 50 million individual members. I have recently served as chairman of the CUNA Committee on Share Insurance and as a member of the National Credit Union System Capitalization Commission, a business group formed to study how to meet the capital needs of the credit union movement in the 1980's. The bills under consideration by this committee will influence not only how credit unions operate tomorrow but also how they develop over the next 50 years.

A week ago we anticipated that the testimony we would present before this committee would be straightforward. We anticipated addressing the merits of S. 2121, a bill introduced by Senator Garn and Senator Proxmire to capitalize the National Credit Union Share Insurance Fund, and S. 2181, a bill, which among other things, would make relatively minor changes in the Federal Credit Union Act as well as changes in other credit-related laws, including usury preemption.

However, our positions on these issues are no longer as clear as they once were. We have had to make our views to some degree conditional on the outcome of a Senate Finance Committee meeting scheduled for today. The Finance Committee is slated to discuss a proposal to tax credit unions. We have only very limited knowledge of the specifics of the proposal. We do not know if the Finance Committee intends to tax credit unions based on size or some other factor, how the Committee plans to take into account unique credit union requirements such as statutorily mandated transfers to reserves, whether there would be an allowance for bad debts similar to the one that applies to savings and loan associations, etc. The Finance Committee has not consulted with credit union regulators on its proposal to tax credit unions or inquired formally or informally about the impact that its plan might have on credit unions. We fear that once again the Finance Committee is pushing legislation without benefit of valuable public input, all in order to avoid evaluating any plan on its merits.

Last March we appeared before the Finance Committee to defend our tax-exempt status. The Committee had no specific tax proposal before it at that time. We described for the Committee the unique nature of credit unions as non-profit, member-owned cooperative financial institutions with membership limited to people with a common association -- generally defined by employment, organization, or geography. We reminded the Finance Committee that credit unions are democratically controlled with each individual member having one vote, regardless of the amount of money on deposit. Credit unions return to their owner-members every penny of income earned in excess of operating expenses, required reserves and undivided earnings. The undivided earnings are necessary to cushion a credit union from adverse economic conditions, such as the volatile interest rates and plant closings that we experienced in the late 1970s.

Some credit unions are very large -- about 73 credit unions have more than $100 million in assets -- but most are relatively small -- over half of the 20,000 in the United States have less than $1 million in assets. While the total of all credit union assets at the end of 1983 crossed the $100 billion mark, this sum is still less than the assets of a single bank, the Bank of America.

CUNA is extremely concerned about any proposal to tax credit unions. We feel that credit unions, whether large or small, operate with the same philosophy. They are run by volunteer boards (by law only one member of a federal credit union board can be compensated), volunteer credit committees and volunteer supervisory committees. This tradition of people working together to help each other was amply illustrated with real life examples in our testimony to the Finance Committee. For instance, we described a large credit union that loaned personnel to a small credit union that was short-handed. We noted that small credit unions may share the same building, equipment and staff to help provide all the services that their members want. We are concerned that taxation will change the basic nature of credit unions, and we will be seen not only by the government, but also by our members, as just another run-of-the-mill financial institution.

Two weeks ago, on February 10, the U.S. Postal Service issued a credit union stamp -- the first ever to honor the millions of men and women, most of them volunteers, who have shown year after year that a financial system which puts people before profits will flourish. The dedication of the stamp is only one of a series of events this year marking milestones in the credit union movement's history. The Federal Credit Union Act will be 50 years old this year. So will the Credit Union National Association. The financial marketplace has changed, as have the operations and powers of credit unions. However, the key to the movement's strength remains the same: people helping people. In good times and bad, credit unions have met their members' needs -- arranging loans for the jobless, deferring payments, even carrying payments until a member was back at work.

We bring up our real concern about being taxed because the specter of taxation colors what we would otherwise say to this Committee today.

S. 2121, Capitalization of the National Credit Union Share Insurance Fund

S. 2121 is a bill introduced at the request of our federal regulator, the National Credit Union Administration. It would require each federally insured credit union to deposit 1% of its insured shares with the National Credit Union

Share Insurance Fund, a government insurance fund administered by NCUA. Since last summer, CUNA has been working with NCUA to formulate a plan to bring the equity level of the Share Insurance Fund, currently at 3/10 of 1%, to at least a 1% equity-to-insured-share level. In early February, the CUNA Executive Committee voted unanimously to endorse the concept of the share insurance fund capitalization plan that is embodied in S. 2121. This position was taken after lengthy consultation with credit unions, leagues, and federal and state credit union regulators. CUNA is still exploring the details of capitalization alternatives to make sure the plan envisioned in S. 2121 is the cheapest one for credit unions and, at the same time, fulfills the agency's goal of invested capital for the insurance fund. NCUA has indicated it will be receptive to any ideas which fulfill these dual goals.

In formulating our position in support of a deposit of 1% of the assets of federally insured credit unions -- an amount equal to about $850 million -- CUNA did not factor in the possibility that credit unions would also become subject to federal income taxation. We believe that credit unions will reconsider this volunteer initiative if it seems they will also lose their tax-exempt status. The plan calls on them to make an $850 million transfer to the federal government. Even though this money will be used to capitalize the Share Insurance Fund, it would reduce the federal deficit by an equal amount.

In addition to the proposal to capitalize the federal Share Insurance Fund, the credit union system earlier this year transferred over $200 million to the Central Liquidity Facility, the "central bank" for credit unions (also administered by the National Credit Union Administration). This too was a voluntary step taken by U.S. Central Credit Union on behalf of virtually all credit unions in the country.

Between the proposed Share Insurance capitalization plan, currently supported by the credit union movement, and the already executed Central Liquidity Facility capitalization plan, credit unions have pledged to transfer approximately $1 billion to the federal government. While this $1 billion supports CU stabilization programs, it also reduces the federal deficit. The Finance Committee estimates that if its proposal to subject credit unions to federal income tax is adopted, it will raise about $300 million over three years. (We do not know if these revenue estimates factor in any tax planning on the part of credit unions.)

A credit union manager who finds his institution is suddenly subject to federal income tax may very well balk at any proposal to shift additional dollars from the credit union to the government. He may question why any additional burden should be undertaken to increase the equity of the Fund when Congress has pledged that the Fund is backed by the "full faith and credit of the United States." That manager will also ask why the Share Insurance Fund, established in 1970, did not receive government seed money, as did the FDIC and FSLIC when they were established.

It has been the tradition and practice of credit unions to be self-help organizations. We have developed a network of credit unions to help other credit unions with their liquidity needs and in providing investment options. We try to deal with our federal and state regulatory agencies with the same goal of self-help in mind. That attitude probably best explains why the credit union movement stands ready to devote $1 billion of credit union resources to the NCUA-administered insurance fund and CLF.

We had hoped to appear here today to express our unconditioned support for the concept of the 1% deposit embodied in S. 2121. Instead, the credit union movement now needs to undertake further study to weigh the effect that the transfer of 1% of their assets will have on their balance sheets if they are subject to federal income tax laws.

We hope that Congress will rapidly conclude that taxation of credit unions will be counter productive. If that happens, then we will urge the Banking Committee to move quickly to report out as separate legislation the plan to capitalize the Share Insurance Fund so that Congress can enact it by mid-year.

We would like to note that the last part of section of S. 2121 that does not pertain to capitalization of the Share Insurance Fund. Sections 14 and 15 of the bill involves the authority of NCUA to establish liquidation payout priorities for federal and state chartered credit unions. NCUA has agreed to drop these sections from any capitalization bill, and the issue will be resolved at the regulatory level.

Title I of S. 2181, "Financial Institutions Competitive Equity Act", and S. 2134, "Depository Institutions Holding Company Act Amendments of 1983"

Title I of S. 2181, which would expand the powers of banks and savings and loan associations through their holding companies, does not directly effect credit unions. Traditionally, it is the policy of CUNA to focus on those issues which allow credit unions to better serve their members rather than being concerned with what services other types of financial institutions may or may not offer to the general public. Even though we are well aware that Title I will form the heart of any omnibus banking legislation that may emerge from this Congress or the next, we see no need to become embroiled in the controversy surrounding whether banks should be allowed to underwrite insurance, deal in certain securities, manage investment companies and participate in real estate development. Credit unions, which as mutual organizations have no holding company structure, are not seeking any broad array of new powers.

S. 2181 does not attempt to impose a "moratorium" on activities of financial institutions and their competitors. We think that it would be difficult, and probably undesirable, to dismantle operations already in place or freeze activities already undertaken. S. 2134 does contain a moratorium on certain activities of "state chartered depository institutions", but unlike the definition of such institutions found in other moratorium bills introduced in the Senate,

S. 2134 would not include state-chartered credit unions since it is an amendment to NOW account legislation. We certainly would oppose any moratorium legislation that would include some or all credit unions, since credit unions are not included in any legislation that would change their traditional role.

Title II of S. 2181, "Credit Union Amendments"

S. 2181 contains seven amendments to the Federal Credit Union Act, none of which should be of interest to any other type of financial institution since the amendments do not affect credit union powers vis-a-vis banks or savings and loan associations. Credit unions are quite happy to retain their consumer orientation and do not seek a change in this role. However, if Congress enacts legislation to tax credit unions, credit unions will have to reevaluate their role in the financial sector and determine if they will need changes in their powers in order to have tax-shelter opportunities available to other depository institutions. Since we do not know the details of the proposal to tax credit unions, it is difficult to predict what changes may be needed in the Federal Credit Union Act. However, based on the proposal made by the Carter Administration in 1978 to tax credit unions, we may need legislation to eliminate Sections 116 and 201(b)(6) of the Act which require specific earmarking of funds as reserves against losses on loans and investments. The 1978 tax proposal would not allow credit unions to deduct the required transfer to reserves before calculating their tax liability. This requirement might have to be eliminated to enable credit unions to pay a reasonably competitive dividend as well as their required taxes. However, such a change could put the Share Insurance Fund at greater risk.

Another change which might be requested if credit unions become taxable financial institutions is the elimination of the current prohibition on compensating all but one member of the credit union's board of directors. As we mentioned earlier, volunteerism is a unique characteristic of credit unions. If Congress decides that credit unions should be viewed no differently than any other type of financial institution, credit union members may be reluctant to ask some of their fellow members to spend long hours and incur the potential liability of sitting on the board without compensation. Credit unions do not now seek such a change in the law. In fact, last spring in response to a study mandated by the Garn-St Germain Act, credit unions overwhelmingly opposed permitting credit union boards of directors to be compensated. This is just one example of the reevaluation of the whole nature of credit unions which will have to be undertaken if credit unions become taxed.

We would like briefly to review the seven amendments in Title II of S. 2181 in order to indicate why credit unions seek them. These seven amendments are also supported by the National Credit Union Administration.

- Section 201 would provide authority for NCUA to allow second mortgages to be made for longer than 15 years. This change is desirable so that credit unions which offer variable rate loans may have the option of extending the repayment period instead of requiring larger periodic payments or a balloon payment at the end of the 15-year period.

- Section 202 would allow a federal credit union the option of establishing a "membership share." This would be an uninsured share representing the member's ownership interest in the credit union. The federal credit union would have the flexibility to establish the terms and conditions of the membership share. The credit union could decide to pay no dividends on the share, to prohibit it from being pledged as collateral, or to redeem the share only upon termination of membership. This was a key recommendation of the National Credit Union System Capitalization Commission and designed to provide the possibility of a more stable capital base.
- Section 203 would eliminate the "faithful performance" bond requirement for credit union officers and employees, and replace it with a requirement for "adequate fidelity coverage," similar to the bond requirements of other financial institutions. The change is needed because courts have interpreted the credit union law to require bonding against events approximating simple negligence. Ultimately, the bond may become prohibitively expensive for the 11,500 federal credit unions.

- Section 204 is merely a technical correction to allow credit union membership officers to be selected from the entire membership rather than from the board of directors (a return to pre-1982 law).
- Section 205 merely makes technical changes in the powers of the credit union's board of directors to carry out the membership share authority and the revised bond coverage requirements.
- Section 206 merely clarifies a provision added by the Garn-St Germain Act on expulsion of members because of non-participation in the credit union. The change clarifies that the two subsections are intended to be alternative ways to handle expulsion of members, either by a vote of the membership or by board action based on established policy.
- Section 207 would allow a state chartered credit union to convert from federal share insurance coverage to other insurance coverage by a majority vote of those who choose to vote, eliminating the requirement that at least 20 percent of the total membership of the credit union must participate in the vote. With this amendment, changes in insurance coverage, charter conversions, and voluntary mergers will require the same voting proceedures.

As already mentioned, these seven amendments were agreed upon by credit unions and their federal regulator before S. 2181 was introduced on the last day of the first session of the 98th Congress. In addition, CUNA has one other amendment that it would like to propose for the Committee's consideration. It involves increasing the so-called "leeway" investment authority in Section 107(7)(I) of the Federal Credit Union Act from 1% to 3%. This change would enable credit unions to increase their participation in service organizations that provide credit union support services.

CUNA is seeking no additional changes in credit unions' statutory powers at this time. However, this may change should credit unions' tax status change.

Title VII, "Credit Deregulation and Availability"

CUNA supports the elimination of the artificial credit constraints of usury ceilings. We feel such business decisions should be the responsibility of credit union boards of directors because they are in the best position to evaluate members' needs, market conditions, and operating capabilities. All federal credit unions and virtually all state chartered credit unions are no longer subject to limits on how much they can pay on share and certificate accounts. Saving rates payable by federally chartered credit unions completely deregulated in April of 1982 -- with the full support of the credit union movement. We now have one side of the balance sheet deregulated, and we urge Congress to take the necessary action to deregulate the other side.

Credit unions are subject to different lending ceilings depending on whether they are federally or state chartered, so relief is needed from both federal and state usury laws. In 1980, Congress increased the 12% federal usury rate ceiling which had existed for federal credit unions since 1934. Congress set a 15% lending rate ceiling but authorized NCUA to set a higher ceiling if conditions warranted. NCUA first exercised this authority in December of 1980 by adopting a 21% ceiling. That ceiling has been extended several times, currently through November, 1984. State chartered credit unions which are still subject to state usury ceilings generally have a ceiling around 21%. Most credit union loans are being made at rates below this ceiling; however, some loans are made at this rate, such as credit card loans.

Credit unions are not seeking the elimination of usury ceilings so that they can make loans at exorbitant rates. Elimination of these ceilings will place the responsibility for setting loan rates where it belongs -- with individual credit unions, not with the government.

Credit unions primarily make consumer loans. We are unique financial institutions which combine a business orientation with a consumer orientation. Removal of usury ceilings on consumer loans should not be viewed as an "anti-consumer" action. It will just assure that regardless of market conditions, savers do not have to subsidize borrowers, and that borrowers are not crowded out when market rates exceed an arbitrary ceiling. We think now is a good time to take action to eliminate usury ceilings for the very reason that market conditions are not causing lending rates to bump up against usury ceilings. Action now will prevent the controversy which inevitably occurs when the issue of usury ceilings is considered at a time when relief is desperately needed by lenders and misinterpreted by borrowers.

Title IV, "Competitive Savings Incentive Act"

Title IV would require the Federal Reserve Board to pay interest monthly on reserves held against money market deposit accounts, super NOW accounts, and any new transaction accounts authorized by the Depository Institutions Deregulation Committee after December 1, 1982. The rate paid would be that earned on the securities portfolio of the Federal Reserve System during that month.

Since the enactment of the "Depository Institutions Deregulation and Monetary Control Act of 1980" all credit unions, whether federally insured or not, have been subject to the reserve requirements of the Federal Reserve Board as have banks and savings and loan associations. If a credit union does not exceed the $2.1 million threshold of transaction accounts and non-personal time deposits, it is only subject to minimal reporting requirements and no actual reserving. Above that level the credit union is subject to reserves whether carried as vault cash or deposits at a Federal Reserve Bank.

CUNA supports the purpose of Title IV and feels that serious consideration should be given to paying interest on all monetary reserves. If the Committee decides to report out this title limited to its current scope, we are concerned about exactly how "comparable accounts" at credit unions will be determined. Credit unions have never been subject to the regulations of the DIDC; the terms and conditions of federal credit union share, share draft and share certificate accounts have been completely deregulated since April, 1982 and most state chartered credit union accounts are also deregulated. Therefore, credit union accounts are not necessarily structured identically to those offered by banks and savings and loan associations. Assumedly, categorization under current Federal Reserve reporting could be determinative in the short-run, but in two years the DIDC is due to disband, and we are uncertain how these accounts will then be tracked.

We are also concerned about the drafting of proposed Section 19(c)(3)(B) which limits payment of interest on reserves of insured credit unions. According to Section 19(b), an insured credit union means federally insured. However, federally insured credit unions and "any credit union which is eligible to make application to become an insured credit union" are subject to reserves. The Fed has interpreted this very broadly, so as even to require monetary reserves from state chartered credit unions whose enabling statutes require them to be state insured. Therefore, the limiting word "insured" should be dropped from Section 402 of the Committee's bill.

Other Provisions of S. 2181

There are several other provisions of S. 2181 affecting credit unions. CUNA would like to comment upon.

Title VI of the bill addresses the problem of delayed funds availability. As other depository institutions have already pointed out to the Committee, the check clearing system is one that has developed over time, handles perhaps 100 million items a day, and is surprisingly efficient. We would be very concerned to see Congress try to make "a quick fix" which could unnecessarily complicate an already complex system and require unwarranted expenses to financial institutions. CUNA is currently querying credit unions to learn about their experiences with check clearing their check hold practices, and their experiences with check-related fraud. (Obviously our generic use of the term "check" also includes share drafts and Negotiable Orders of Withdrawals.) We are soliciting views on how to best improve the system. CUNA is reviewing whether any meaningful disclosure guidelines can be developed that will help alert members to practices that may delay them access to their funds (and that can help a credit union to formalize its policies on funds availability).

We urge Congress not to try to proceed to enact legislation i. this area at this time. We think efforts such as the Federal Reserve System's pilot program in the Dallas region to speed up return items should be evaluated and probably expanded. We think industry groups should work on voluntary efforts. And we think that Congress should study the issue in great detail before it considers preempting the rules in the Uniform Commercial Code. The bottom line is that delayed funds availability will never be completely eliminated in a paper-based transaction system.

Title VIII of S. 2181 authorizes the payment of interest on demand deposit accounts. Since federal credit unions do not have deposit authority, they are not affected by that provision of the bill. However, Title VIII also adds non-profit political committees and groups to the list of organizations eligible for NOW accounts. Since credit union organizations are now increasingly active in political fundraisers, we request equal treatment be given to share draft authority by amending Section 205(f)(2) of the Federal Credit Union Act.

Title IX addresses the problem of fraudulent use of credit and debit cards. The proliferation of plastic cards throughout the nation has also brought a large increase in the illicit use and duplication of cards. Annual dollar losses are mounting, and federal laws are presently insufficient to deal with the problems. CUNA supports the changes to the Truth-in-Lending Act and the Electronic Fund Transfer Act proposed in Title IX.

Section 2120, Tax-Exemption for the Central Liquidity Facility

S. 2120 introduced by Senator Garn and Senator Proxmire at the request of the National Credit Union Administration, will correct an oversight in the legislation which created the Central Liquidity Facility, the "central bank" for credit unions. Originally, the CLF was to be part of the NCUA and therefore would incur no tax liability. Because of some committee jurisdictional problems, and the desire to pass the bill before Congress adjourned in 1978, the CLF was established as a mixed ownership corporation administered by NCUA. Unfortunately, language specifically granting the CLF tax-exempt status was not included in the final legislation, and the Internal Revenue Service has been unwilling to rule that the CLF should receive tax treatment comparable to similar types of organizations. Therefore, S. 2120 proposes to resolve this problem by adding a new Section 311 to the Federal Credit Union Act, explicitly granting tax-exemption to the CLF. CUNA strongly endorses S. 2120. The Treasury Department also has no objection to the proposal. We urge this Committee to resolve any jurisdictional problems with the Finance Committee, so that Congress has an opportunity to enact this legislation as quickly as possible.

S. 2122, "Payroll Deduction Facilitation Act"

CUNA strongly supports S. 2122, a bill which would eliminate the charging of fees for federal civilian employee allotments. It would also make limited changes in the "Right to Financial Privacy Act" in order to permit the transfer of information necessary to carry out the disbursing function. These changes would bring the payroll practices of the Federal government in line with the private sector and also in line with practices which apply to military personnel. Although it is difficult to estimate the impact on savings that this bill may have, it is certain that the cost of these allotments to credit unions can now be returned to our members in the form of increased dividends and lower loan rates.

The Treasury Department supports enactment of this legislation. It feels the bill will improve government efficiency and aid Treasury in making full use of advanced electronic funds transfer technology. Treasury also feels the legislation will provide uniformity for all government allotments programs and is consistent with the Administration's goal of standardizing government financial procedures. We urge the Committee to quickly report S. 2122.

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We thank the Committee for the opportunity to testify on a number of proposals before the Congress that will affect credit union operations. We hope that members of the Banking Committee will study the question of whether taxation of credit unions will ultimately change the traditional role of credit unions in serving the savings and borrowing needs of people of relatively low and moderate financial means. The tax writing committees of Congress are understandably looking for ways to reduce the $200 billion deficit. We question if the increased revenues from credit union taxation would begin to justify the dislocations that might occur in the credit union movement. We think members of the Banking Committee are in the best possible position to make the necessary assessment. We hope that each of you will conclude that the tax-exempt status of credit unions should be continued, and convey that conclusion to your colleagues in the Senate.

I thank you and will be willing to answer any questions.

Credit Union National Association, Inc.
1730 RHODE ISLAND AVE. N.W. • WASHINGTON, D.C. 20036 • 202-828-4500

February 28, 1984

The Honorable Jake Garn
U.S. Senate
Washington, DC 20510

Dear Senator Garn:

This letter has two purposes: 1) to thank you for recommending to Senator Dole that the Senate Finance Committee not consider taxing credit unions at this time and 2) to reiterate that with the changes in S. 2121 that you announced today CUNA unreservedly endorses this legislation and supports your efforts to assure its prompt passage.

Enactment of S. 2121, the bill to capitalize the Share Insurance Fund, is a priority matter for the credit union movement, which has been discussing how best to meet its long-term capital needs for nearly five years. CUNA formed the National Credit Union System Capitalization Commission for this purpose in 1981. In April, 1982, the National Credit Union Administration, after lengthy consultation with credit unions, formally adopted a policy goal of raising the equity of the Share Insurance Fund to the 1% operating level set by Congress. CUNA, too, endorsed this goal and thereafter set about studying plans for its attainment, including the one detailed in S. 2121. CUNA sent its 17,698 affiliated federal and state chartered credit unions a special background paper explaining the legislative proposal. It was examined at league and chapter meetings and discussed with the more than 1,000 credit union executives who attended CUNA's recent Governmental Affairs Conference.

NCUA also devoted its resources to making certain that credit unions understood the proposal and had ample opportunity to comment upon it. The agency produced a video tape on the plan and sent it to all 50 credit union leagues, trade groups, its six regional offices, its examination force and any credit union that requested a copy. In addition, the agency mailed the managers and boards of all federally insured credit unions a letter requesting that they verify the plan's impact on their individual credit union's balance sheet. Over 1,800 credit unions responded to this mailing, and the overwhelming majority endorsed the plan.

This review is meant to underscore that the capitalization plan has been thoroughly discussed with credit unions and that it has broad based support at the grassroots level as well as among credit union leadership. We hope that Congress will enact S. 2121 quickly so that credit unions can get about the business of putting the capitalization plan into operation.

Yours sincerely,

Tom Welsh

Harold T. (Tom) Welsh
Chairman

The **Chairman**. Thank you, Mr. Hellie.
Mr. Hutchinson.

STATEMENT OF JOHN J. HUTCHINSON, MANAGER, HAMILTON STANDARD FEDERAL CREDIT UNION, WINDSOR LOCKS, CONN.; PRESIDENT, NATIONAL ASSOCIATION OF FEDERAL CREDIT UNIONS

Mr. **Hutchinson**. Thank you, Mr. Chairman.
[The complete statement follows:]

Introduction

Mr. Chairman and members of the Senate Banking Committee, I am John J. Hutchinson, President of the National Association of Federal Credit Unions (NAFCU) and manager of Hamilton Standard Federal Credit Union in Windsor Locks, CT. The National Association of Federal Credit Unions is the only national organization exclusively representing the interests of credit unions chartered by the federal government. There are about 11,400 Federal credit unions in the United States, representing over 27 million members.

I appreciate this opportunity to comment today on the various financial institution bills pending before the committee. At the outset, I want to commend you, Mr. Chairman, for convening these hearings and providing a forum in which the important issues addressed in these bills may be reviewed and debated.

While much of the financial legislation under consideration during these hearings could have an impact on Federal credit unions if enacted, I want to focus my comments today on those bills which would affect Federal credit unions directly. These include: S. 2120, to exempt the Central Liquidity Facility from federal taxation; S. 2121, to increase the capitalization of the National Credit Union Share Insurance Fund and to clarify the authority of the National Credit

Union Administration Board to determine the order of distributions to creditors when a Federal credit union is liquidated; S. 2122, the Payroll Deduction Facilitation Act; and S. 2181, the Financial Services Competitive Equity Act.

S. 2120, Tax Exemption For National Credit Union Central Liquidity Facility

The Central Liquidity Facility (CLF) was established by Congress in late 1978 to provide a source of liquidity for credit unions throughout the country. The CLF has served an important role as a liquidity lender and as a provider of capital to help credit unions needing short-term stabilization assistance.

The current NCUA Board has done an excellent job in overseeing the operation of the CLF. In fiscal year 1983, total operating expenses were reduced by 52%, from $1.3 million in fiscal year 1982 to $609,502. In addition, the CLF's income of $8.4 million translated into a 9.2% return on deposits for CLF members. Further, the CLF's equity position increased by over $1.4 million in FY 1983, almost a 100% increase from FY 1982.

Nevertheless, the operation of the CLF is clouded today as a result of a drafting error contained in P.L. 95-639, which created the facility. When the CLF was established, it was not the intent of Congress that it should be subject to

Federal taxes. However, the language providing a tax exemption for the CLF, organized as a mixed ownership corporation, was omitted due to the haste in which the measure was considerd during the waning days of the 95th Congress. Despite the fact that it was not Congress' wish that the CLF be taxed, the facility has made payments to the Internal Revenue Service totalling more than $227,000 for tax years 1980 through 1982. For tax year 1983, the CLF's liability is $1.1 million. Last October the IRS has informed NCUA, "if legislation granting an exemption retroactive to October 1, 1979, has not been passed by December 31, 1983, we will issue statutory notices of claim disallowance."

Mr. Chairman, you and Senator Proxmire recognized the handicap under which the CLF is operating when you, at the request of NCUA, introduced S. 2120. The National Association of Federal Credit Unions has supported similar legislation for several years. Since the CLF serves only credit unions with no budgetary allocation from the government, and since credit unions are non-profit organizations just as the CLF is, we urge Congress to pass the CLF tax exemption as expeditously as possible.

S. 2121, Capitalization of the National Credit Union Share Insurance Fund and Creditor Payout Priorities

Of all the financial institution issues pending before the committee today, there is none of more interest and concern to credit unions than the share insurance fund. The current National Credit Union Administration Board, under the direction of Chairman Edgar Callahan, has continued to recognize the need for a sound fund.

The NCUA Board has proposed a plan which will accelerate funding by mandating an immediate capitalization directly from insured credit unions. Under NCUA's plan, each insured credit union would deposit an amount equal to 1% of the credit union's insured shares. The amount of the deposit would be maintained annually at 1% of each credit union's insured shares. Credit unions would continue to pay annual insurance premiums. However, if the expenses of the fund are met and the ratio of equity to insured shares in the fund is maintained at 1.3% -- which represents the immediate capitalization at 1% of insured shares plus the present .3% capitalization level -- credit unions should receive a rebate. This plan is embodied in S. 2121, which was introduced last fall at the request of NCUA.

NAFCU agrees with NCUA that credit unions need a healthy, independent share insurance fund. When NAFCU was formed in 1967 to give Federal credit unions a stronger voice in Washington, one of our initial goals was the establishment of a system of federal insurance for credit union share accounts. In spite of the overwhelming opposition to it at that time, we felt such insurance would go a long way toward maintaining members' full confidence in the credit union system. Since

1970 when the fund was established, the number of individuals served by credit unions has more than doubled from 23 million to over 47 million today. Likewise, the assets of the credit union industry have grown from $24 million in 1970 to approximately $100 billion. All Federal credit unions must be insured by the Fund; others may participate voluntarily or by individual state statutory requirement. We strongly believe that the existence of the federal share insurance program has played a key role in the growth of and trust in the Federal credit union system.

NAFCU continues to support mandatory share insurance, and stands ready to support strengthening the fund. However, we reserve the right of our member credit unions to study and recommend how that should best be accomplished.

NAFCU supports the underlying concept of a plan to further capitalize the share insurance fund, that is, to bring the ratio of equity of insured shares to a higher level. However, a number of our members has raised questions about the NCUA plan as proposed. In addition, some have asked that alternative plans be fully analyzed and compared to the NCUA plan. We believe that these are important and necessary steps in the process of determining how best to further capitalize the share insurance fund. What our members are asking for is a little time to thoroughly study the complex subject of capitalization.

NAFCU has made a concerted effort to educate our members regarding the capitalization issue. For example, at our Congressional Caucus in January, which you addressed Senator Garn, we provided a forum for credit union officials to hear from and discuss the issues and their concerns with the NCUA board and staff.

NAFCU is exploring the implications of S. 2121 with the National Credit Union Administration Board and discussing optional plans. We are also in the process of surveying our membership on the issue of capitalization, the results of which we will share with the committee as soon as possible.

Before leaving the issue of share insurance, I want to reiterate that NAFCU supports a strengthened fund. We have great concern about the impact that reserving 1% of shares could have on some credit unions. We believe that some changes to S. 2121 may be necessary if capitalization is to be reached in the least burdensome manner for credit unions.

S. 2121 also contains authority for the National Credit Union Administration Board to determine payout priorities for creditors when federally insured credit unions are liquidated. It also provides that the board's recovery of insurance payouts for a state chartered, federally insured credit union would be the same as for a federally chartered credit union, and that state law does not supercede the board's right to recover.

We believe that under the Federal Credit Union Act, the National Credit Union Administration Board has the authority to determine the priority of payouts resulting from the liquidation of a Federal credit union. However, we believe that it would be desirable for the statute to be amended to further clarify NCUA's authority in this regard.

In April, 1982, the NCUA Board issued an interpretive ruling and policy statement establishing new payout priorities in connection with the liquidation of Federal credit unions. Under this statement, the National Credit Union Share Insurance Fund and credit union members with uninsured shares would have the same status as unsecured creditors. Previously, the fund and members with uninsured shares were paid after unsecured creditors.

This ruling was challenged in United States District Court for the District of Columbia as being in violation of the Administrative Procedures Act (APA), because the board did not provide a comment period. Also, the suit challenged the substance of the ruling on the grounds that the board does not have legal authority to change the payout priority.

In October, the court ruled that NCUA had violated the APA, but it did not rule on whether the board had authority to change the order of distributions when a credit union is liquidated. Subsequently, the board reissued the policy statement as a proposal on November 10, 1983, with a 30 day comment period. The proposal is scheduled for consideration during the board's March meeting. At the same time, the board sought a legislative remedy to forestall further challenges to its authority in this regard. NAFCU recognizing there are certainly other concerns in this matter, supports NCUA's effort to obtain this leglislation. We feel it could strengthen the share insurance fund.

S. 2181, The Financial Services Competitive Equity Act

This is a massive bill that, if enacted, would have far-reaching effects on financial institutions. For the sake of brevity, I will generally restrict my comments to those portions of the legislation which explicitly address Federal credit unions.

Title I

Section 104 -- Consumer banks. This provision would establish a new class of financial institutions known as "consumer banks." While NAFCU does not oppose this provision, we question the need for a new group of institutions when a wide variety of financial services is already available to consumers.

Title II -- Credit Union Amendments

Section 201 -- Second Mortgage Loans. This legislation would permit the National Credit Union Administration Board to allow Federal credit unions to offer second mortgage loans with a maturity of greater than 15 years. We believe that Federal credit union officials should have the flexibility to respond to the marketplace and not be hampered by restrictive laws. We fully support this legislative change.

Section 202 -- Membership Shares. This provision would permit Federal credit unions to offer non-insured shares to their members. These instruments would be uninsured, but they could have a par value and pay dividends as determined by the credit union's board of directors. Supporters of this concept argue that the use of uninsured shares would allow credit union members to share in the risks associated the operation of a financial institution and permit the credit union to build a pool of capital. We are not convinced that this concept is necessary or would benefit credit union members. We believe that all shares, up to $100,000, should be insured, as in all other financial institutions. To single out some shares as uninsured and others as insured would not be in harmony with our cooperative nature and would confuse many savers. We oppose this provision.

Section 203 -- Faithful Performance. This provision removes the current "faithful performance" standard required for Federal credit union employees and officers. It replaces it with an "adequate fidelity coverage" standard. This new standard would be defined by the National Credit Union Administration Board. NAFCU is concerned about this provision and feels it may be as confusing as the current "faithful perofrmance" standard is since we are uncertain as to what would constitutes "adequate fidelity coverage." We recommend that, if this provision is retained, a clear definition of "adequate fidelity coverage" be provided either in the legislation or accompanying report. We neither support nor oppose this amendment at this time.

Section 204 -- Membership Officers. This language would correct a technical error contained in the Garn-St Germain Act to allow the membership officers of a credit union to be chosen from the members at large, rather than from only among the credit union's board of directors. NAFCU strongly supports this technical correction.

Section 205 -- Powers of the Board of Directors. These provisions would add some new authorities for the board of directors of a credit union, consistent with other sections of Title II of S. 2181. NAFCU is not opposed to the provision that would require the board to provide adequate fidelity coverage for officers and employees that handle funds; however, as mentioned previously, "adequate fidelity coverage" must be more clearly defined.

NAFCU does oppose Sections 205(2), 205(5), and 205(6), which deal with the board of director's authority to determine whether a membership share will be established; the par value of membership shares; and the dividend rates to be paid on membership shares. Again, we question the value of uninsured membership shares and are not convinced that credit union boards should be permitted to establish this new type of share.

Section 206 -- Nonparticipation in the Credit Union. This provision would allow a credit union to expel a member by either a two-thirds vote of the members or by a majority vote of the board of directors. While expulsion is an action of last resort for credit unions, it is important that alternatives exist for dealing with this situation, and we support this provision. We also believe that both methods provide adequate safeguards for members.

Section 207 -- Change in Insurance Status. This language would make it easier for state chartered credit unions to convert from federal to state or private share insurance. Under current law, conversion from federal share insurance to another form of insurance requires the approval of a majority of the credit union's board of directors and approval from a majority of the credit union's voting members. At least 20% of the credit union's membership must participate in the vote for it to be valid. This amendment would eliminate the 20% requirement. NAFCU is opposed to this change. We believe that the present law has served us well and NAFCU's members have not sought a change. We urge the committee to drop this provision from S. 2181.

Title IV Competitive Savings Incentive

Section 402 -- This provision would require the Federal Reserve to pay monthly interest payments on the Regulation D reserves held against money market deposit accounts or their equivalents, including money market share accounts and Super Now accounts. NAFCU has supported the payment of interest on all Regulation D reserves for a number of years and we urge the committee to approve this provision.

Title VI--Fair Deposit Availability

This title attempts to address a problem of growing magnitude in this country -- anti-consumer policies by some financial institutions. Specifically, this title addresses check holding policies and the computing and crediting of interest on deposit accounts. Recently, as a result of the attention drawn to this issue by this panel and by your House counterpart, we have seen stories frequently in the media that demonstrate a flagrant disregard for the financial needs of consumers. We feel increased disclosure requirements and guidelines will help these financial institutions understand their obligations with respect to their depositors. Thus, NAFCU supports the underlying goals reflected in this amendment.

However, we ask this panel to exclude Federal credit unions from the purview of this title. Federal credit unions, because they are owned and controlled by their members, have an excellent record in providing adequate disclosure as well as services that are well tailored to the needs of their consumer-members. We feel that these provisions would be superfluous and an unnecessary regulatory burden for Federal credit unions.

Title VII--Credit Deregulation and Availability

Section 704 -- Federal Credit Union Loan Rate Ceiling. This provision would eliminate the statutory loan rate ceiling now placed on Federal credit unions and permit each board of directors to decide for themselves what rate of interest they should charge for their loans. We have staunchly supported such legislation for a number of years, and we urge the committee to adopt this provision. Currently, federal credit unions are the only federally chartered institutions that have a federally-imposed loan rate ceiling. Federal credit unions were the first group of traditional depository institutions to be deregulated on the liability side, as NCUA deregulated share accounts in March, 1982. We have adjusted well as the statistics show. The record of Federal credit unions is clear. They traditionally have set loan rates below the statutory limit whenever possible. In this era of deregulation, Federal credit union boards of directors should be allowed to make this important decision. We are hopeful that Congress will remove the loan rate ceiling this year.

In addition to these provisions, we have recommended a few minor technical corrections to Title II, Credit Union Amendments, of S. 2181. We have communicated these changes to Senate Banking Committee staff in a letter dated January 12, 1983. I have attached a copy of our proposed technical amendments to our testimony.

S. 2122, Payroll Deduction Facilitation Act

This measure, introduced last November by you, Mr. Chairman, and Senator Proxmire, would remove a significant barrier to saving that now exists for federal civilian employees. If enacted, S. 2122 would eliminate the current fees imposed by the Treasury Department on financial institutions that receive payroll allotments on behalf of federal civilian government employees.

Currently, the Federal government will absorb the administrative costs of sending one allotment per pay period to a federal civilian employee's financial institution. However, the government must be reimbursed by the financial institution for any costs related to the processing of additional payroll allotments. In 1968, the Treasury Department was given the authority to determine and collect these service charges, which are currently six cents per each payroll allotment and 12 cents for each check sent to a financial institution beyond the first free allotment. Since today most allotments are made by magnetic tape or wire transfer, the necessity of making this charge should have been negated.

While this amount may seem small, collectively it amounts to millions of dollars, a cost that many Federal credit unions find hard to accept. Currently, 84% of the nation's credit unions pay for the processing of federal civilian employee allotments.

For a variety of reasons, we feel that it is grossly unfair for the federal government to pass the costs of processing deductions along to financial institutions. Most employers in the private sector provide this service at no cost to their employees or to the recipient financial institutions. The federal government stands out as one of the few employers which charge a fee for allotments.

In addition, both active duty and retired military personnel, as well as civilian federal employees working overseas, are exempted from any charges for allotments. Federal civilian employees located in the U.S. are the single group of federal employees chosen to bear this burden.

Further, credit unions are cooperative financial institutions. This means that the cost of payroll allotments for federal civilian employees who belong to credit unions is shared by the entire membership of their credit union. This results in higher loan rates or lower dividends to offset the expense.

In May of 1982, the Treasury Department proposed to increase service charges from 6 to 12 cents for each payroll allotment and from 12 to 27 cents for each check. Following sharp criticism from many Members of Congress, including you, Senator Garn, Treasury Secretary Donald Regan "postponed indefinitely" the increase in allotment fees. However, we are concerned that unless Congress acts, the Treasury may again try to increase these charges. We urge Congress to focus on this important issue. This unfair disincentive for saving must be removed and the federal government must accept the responsibility for its own employees.

Summary

This concludes my remarks concerning the financial institution legislation now pending before the Senate Banking Committee. However, I would like to take this opportunity to publicly thank Senators Garn and Proxmire, and your colleagues on this committee, for your ardent support of the resolution enacted last year designating June 24-30, 1984, as "Federal Credit Union Week."

Both of you, as well as many other Members of Congress, also supported the Federal credit union commemorative stamp. This 20-cent, first class postage stamp was first issued by the United States Postal Service on February 10, 1984 in Salem, MA, the birthplace of one of the founders of credit unions in this country, Edward A. Filene. The stamp, coupled with the resolution, recognizes the important role Federal credit unions play in today's marketplace. It also honors those individuals in this country, now more than 27 million strong, who support Federal credit unions.

This year marks the 50th anniversary of Federal credit unions in the United States. We have come a long way in 50 years and have seen many changes in the financial services industry. One thing has not changed, however, that is the volunteer cooperative self-help spirit of Federal credit unions. I am confident that working with Congress and the National Credit Union Administration to maintain a strong share insurance fund, obtain relief from the loan rate ceiling, and achieve enactment of the other provisions we have endorsed today, we can look forward to even greater years of growth and prosperity for Federal credit unions.

APPENDIX I

TECHNICAL PERFECTING AMENDMENTS TO TITLE II OF S. 2181:

On page 59, line 3:	strike the comma following the word "Indian".
On page 59, line 7:	insert "credit unions serving predominately" following the word "of".
On page 59, line 8 and 9:	strike the words "funds for credit deposit accounts and".
On page 59, line 23:	strike "122" and insert in lieu thereof "113".
On page 60, line 20:	strike "(5)" and insert in lieu thereof "(3)".
On page 60, line 24:	strike "(6)" and insert in lieu thereof "(4)".

The CHAIRMAN. Thank you very much. I congratulate you on your 50th anniversary. I just feel badly that I'm older than the credit unions.

Mr. HUTCHINSON. Don't we all?

The CHAIRMAN. I still can't believe that—I always remember asking my mother when my father turned 50 how long she thought he would live, and I have an entirely different perspective now than I had at that period of time.

Yesterday afternoon I sent Senator Dole, the chairman of the Finance Committee, a letter concerning my activities on S. 2121. As both of you know, the suggestion of the $300 million taxation over 3 years came from the Grace Commission report and I'm sure the Grace Commission had no idea, did not look into the activities of this committee or the bill in the effort to increase the capitalization of the share insurance fund, the $200 million already put up for the central liquidity fund.

Senator Dole was not aware of our activities and that's why I took it upon myself to speak to him yesterday afternoon as well as write him a letter, and I would ask unanimous consent—and I'm not going to object to my own request—to place my letter to Senator Dole in the hearing record today.

[The letter follows:]

JAKE GARN, UTAH, CHAIRMAN

JOHN TOWER, TEXAS
JOHN HEINZ, PENNSYLVANIA
WILLIAM L. ARMSTRONG, COLORADO
ALFONSE M. D'AMATO, NEW YORK
SLADE GORTON, WASHINGTON
PAULA HAWKINS, FLORIDA
MACK MATTINGLY, GEORGIA
CHIC HECHT, NEVADA
PAUL TRIBLE, VIRGINIA

WILLIAM PROXMIRE, WISCONSIN
ALAN CRANSTON, CALIFORNIA
DONALD W. RIEGLE, JR., MICHIGAN
PAUL S. SARBANES, MARYLAND
CHRISTOPHER J. DODD, CONNECTICUT
ALAN J. DIXON, ILLINOIS
JIM SASSER, TENNESSEE
FRANK R. LAUTENBERG, NEW JERSEY

M. DANNY WALL, STAFF DIRECTOR
KENNETH A. McLEAN, MINORITY STAFF DIRECTOR

United States Senate

COMMITTEE ON BANKING, HOUSING, AND
URBAN AFFAIRS
WASHINGTON, D.C. 20510

February 27, 1984

The Honorable Robert Dole
Chairman
Committee on Finance
United States Senate
Washington, D.C. 20510

Dear Bob:

I understand that the Finance Committee is considering various proposals designed to increase government revenues and to decrease the burgeoning federal deficit. Among such proposals is one to obtain approximately $300 million in revenues over the next three fiscal years by taxing the net income of credit unions. While I certainly support efforts to reduce the deficit, I do not believe that the taxation of credit unions is the most effective way of pursuing that goal, and recommend that the Finance Committee not consider this proposal.

In addition to my concern that an issue of this significance be more thoroughly examined, I believe that there are compelling substantive reasons why taxation is not appropriate at this time. First, credit unions are in need of capital and are being encouraged by the National Credit Union Administration ("NCUA") and their industry associations to retain revenues in capital surplus type accounts. Taxation could adversely affect this effort by reducing the amount of net revenues available for such surplus treatment. Second, during the first week of this month credit unions made a capital transfer of over $200 million to the NCUA-managed Central Liquidity Facility ("CLF"), the central bank for credit unions. The effect of this capital contribution is not only to provide a stronger liquidity facility for credit unions but to reduce the federal deficit by an equal amount. Third, I introduced a bill (S. 2121) last November, at the request of the NCUA, to recapitalize the National Credit Union Share Insurance Fund ("NCUSIF") by increasing its capital by $850 million. This would be accomplished through credit union capital contributions and would increase the capitalization of the fund from $240 million to over $1 billion. This is deemed necessary because the NCUSIF is less capitalized than the FSLIC or FDIC deposit insurance funds, due to the growth of credit unions and to the absence of any initial federal capitalization (which both the FSLIC and the FDIC received when they were established). In a manner similar to the CLF capital contribution, the $850 million would be treated as federal funds for purposes of reducing the deficit.

I intend to pursue consideration of S. 2121 in the Banking Committee and anticipate its enactment this year. This legislation, together with the CLF capital contribution, would amount to a reduction in the federal deficit of over $1 billion. It is clear to me that these actions are necessary to maintain the continued stability and growth of the credit union system. Because credit unions, as self-help, member-owned organizations, are being asked to contribute $1 billion in capital to the government for the continued soundness of their institutions, I do not believe it wise or beneficial for credit unions or the government to consider taxing credit unions at the same time. Thus, I again urge that the Finance Committee not consider the taxation of credit unions.

Sincerely,

Jake

Jake Garn

JG/jch

COULD JEOPARDIZE $1 BILLION REDUCTION IN FEDERAL DEFICIT

The CHAIRMAN. Essentially what it does, it simply says, "Hey, I do not believe it is appropriate to talk about $300 million of taxation and jeopardize a $1 billion reduction in the Federal deficit, at the same time increasing the security of credit union members' deposits in their various credit unions."

I have not had the time to assess the other members of the Banking Committee, but I would expect that they would feel the same way, that it's not a very good trade with $300 million in taxation compared to $1 billion.

So I very strongly feel that we should continue with the efforts to pass S. 2121 and work out the differences and the mechanics of how that $850 million should be put in. It seems to me it makes a great deal more sense for the Federal budget deficit to have $1 billion or an additional $850 million reduction in the deficit which serves another purpose, rather than just taking money away from people as taxation does.

So I wanted you to be aware of that, that I did write Senator Dole that letter so that he was fully aware of the activities of this committee and hopefully he will make other members of the Finance Committee aware of that and that it would not make a great deal of sense for $300 million to jeopardize $850 million of additional revenue to the Federal Government for deficit reduction.

Mr. HUTCHINSON. Mr. Chairman, may I just say at this point that we appreciate that effort on your part. We sincerely appreciate the fact that you are fully cognizant of the impact that would have upon credit unions. We want to go on record as thanking you for that effort.

The CHAIRMAN. NCUA has proposed amending S. 2121 to accommodate suggestions made by credit unions. These changes would:

One, require NCUA to submit an annual report to Congress regarding the fund's operating level. The report shall also include an independent audit.

Two, remove authority for NCUA to charge a second annual insurance premium.

Three, direct that credit union capital contributions to the fund be repayable if the fund is transferred out of NCUA.

Four, delete the liquidation payout priority provisions from the bill; and

Five, change the title to reflect that credit unions are themselves strengthening the share insurance fund.

Do you believe that these changes satisfy the concerns of your members?

Mr. HELLIE. Yes, Mr. Chairman. CUNA would unreservedly support the bill with those changes.

Mr. HUTCHINSON. We are appreciative of those changes. I think some of them were suggested in our testimony, Mr. Chairman.

The CHAIRMAN. Do you have other suggestions for changes?

Mr. HELLIE. We do not.

Mr. HUTCHINSON. Mr. Chairman, I would inform you of the fact that we are in the process of surveying our membership to determine whether or not the method of capitalizing the fund proposed in S. 2121 is one the credit union can in fact accept or if there are better alternatives out there. We would like to hear that from our membership and we will hear that.

Mr. HELLIE. Mr. Chairman, for a point of information or clarification, as I pointed out in my testimony, there are 19,240 credit unions and over 19,000 of them are members of CUNA. Of the 600-plus credit unions who are members of NAFCU, 80 percent of those are also members of CUNA. So all of those people have already been advised of this. CUNA began studying this in May 1983 and every federally insured credit union, regardless of charter, has received a communique from NCUA explaining their proposal. And it seems to me the legislation permits the discussion and the arrangement of developing the best alternative as long as the idea goes forward. So all I'm saying is that this idea will come as no surprise with or without NAFCU's survey.

The CHAIRMAN. Well, I would hope you would continue to review these changes in your position with your membership and communicate to the committee what those feelings are so that they can be included in the record because also in the letter that I sent to Senator Dole is a commitment to proceed with S. 2121 and because I can't in good conscience say, "You back off $300 million worth of taxes, because we're going to take $850 million from them that will give you an extra $550 million budget deficit reduction"—when people look for downpayments, that's a pretty good downpayment, at least from one segment of the community.

But I think in order to do that, communicate to him those feelings, that I also make that commitment that we move ahead with it as rapidly as we can.

Gentlemen, I have some additional questions. Most of them are rather technical in nature, questions on capitalization. I think in the interest of time I will submit them to you for your response in writing.

Do you have any additional comments you wish to make?

[No response.]

The CHAIRMAN. Thank you very much. We appreciate your being here.

[The following information was subsequently submitted for the record:]

National Association of
Federal Credit Unions
P.O. Box 3769
Washington, DC 20007
703/522-4770

March 19, 1984

The Honorable Jake Garn
Chairman
Committee on Banking, Housing
and Urban Affairs
United States Senate
Washington, DC 20510

Dear Mr. Chairman:

During testimony on S. 2121 before your Committee on February 28, 1984, I reported that the National Association of Federal Credit Unions was surveying membership as to their desires, concerns or recommended position on this important legislative proposal. You commented that day that you hoped we would continue to review proposed changes with our membership and "communicate to the Committee what their feelings are."

We are satisfied at this time that sufficient membership response has been received to give us a positive position on the bill. NAFCU's membership supports the capitalization of the share insurance fund as proposed in S. 2121. There is enough concern expressed by our members, however, for the NAFCU Board of Directors to ask for a phase-in of the capitalization. This would allow time for credit unions to liquidate or adjust investments and to plan their cash flow to provide the amount required to further capitalize the NCUSIF.

Fortunately, S. 2121 includes a provision for a phase-in. It states:

> The Board (NCUA) may, in its discretion, authorize insured credit unions to initially fund such deposits over a period of time in excess of one year if necessary to avoid adverse effects on the condition of insured credit unions.

NAFCU's Board, acting for its membership, asks for a three-year phase-in for all credit unions. Such an arrangement would infuse approximately $270 million in new capital into the NCUSIF in each of the next three years. This would reach the goal of capitalizing the fund at 1.0% of insured shares above the present equity of 0.3% of insured shares in a manner less burdensome than would be a single deposit. At the same time, credit unions would help to reduce the federal deficit each year at a rate nearly three times the amount anticipated in recent proposals to tax credit unions.

We are pleased to support the legislation that will make the NCUSIF stronger than ever. We applaud NCUA for developing this bold and straightforward plan. We also thank you, Mr. Chairman, for your continuous interest in a strong credit union system in the United States. Your foresight in offering S. 2121 at this time is commendable.

NAFCU stands ready to offer all the assistance we can to see that S. 2121 becomes law of the land with those conditions we have asked for being fully considered.

Sincerely,

John J Hutchinson

John J. Hutchinson
President

JJH:yrz

The CHAIRMAN. Now if I could have Mr. Robert B. Evans, president of American Financial Services Association come to the witness table.

Mr. Evans, I would note before you begin that you represent a new trade group as well. Everybody seems to be changing their names and consolidating. It used to be essentially finance companies, but the new group, American Financial Services Association, is now for all financial services companies and is a broader group than you represented in the past.

STATEMENT OF ROBERT B. EVANS, PRESIDENT, AMERICAN FINANCIAL SERVICES ASSOCIATION

Mr. EVANS. That's correct, Mr. Chairman, and I appreciate your mentioning that. It saves me from the commercial I had to make last time.

I want to thank you for this opportunity to appear and again address the issue of financial services deregulation. We especially appreciate the opportunity to comment on S. 2181 and particularly the provisions of title 1 which would authorize establishment of consumer banks.

You may recall last June we were concerned, as were others, about a proposal to freeze further innovation and experimentation in the financial services marketplace. These proposals would call for a moratorium or a moratoria, if you prefer. The net effect would be to segregate players in the marketplace and probably permanently.

We're no less concerned today but it is a pleasure indeed to be able to address alternatives, which as unsettling as it may appear to some to be, nevertheless elevates the debate about who gets to play; that is, who is grandfathered; and who gets what now.

In the latter case, we respectfully submit it's the consumer. Now this is not to say that there may be some legitimate concerns. Debate over the appropriate role of Government in the American financial system is as old as the Republic itself. Throughout the country's history an important driving force in this debate has been an inherent fear among Americans about any tendencies toward centralized political or economic power. Thus, concerns manifested from some today, that a handful of private firms will control finance.

VIGOROUS COMPETITION IS BEST ANTIDOTE

But what is so often overlooked in these debates and speculation over centralization is that the best antidote to monopoly is not more regulation, but more vigorous competition.

Competition assures that financial services or products are available to those who demand them at minimum production cost. Competition causes resources to be allocated to their most productive uses and competition reduces potential conflicts of interest and concentrations of power that along with higher prices are found in uncompetitive markets.

But most importantly and most often overlooked, to insure these benefits of competition, free entry into the market system is an essential prerequisite. As soon as substantial barriers to free entry are put in place, the competitiveness of markets begins to deteriorate and the benefits to customers decline. As competitiveness ebbs, the quality of service declines, the cost rises, or both.

Now moratoria do not enhance free entry into the market. They stifle it. You, Mr. Chairman, are to be commended for steps you have taken in recent years to improve competitiveness of consumer-oriented financial markets. We hope the committee will continue its leadership in this area by adopting legislation advancing the concept of consumer banks.

Consumer banks are financial institutions that engage in deposit taking and extension of consumer credit but whose corporate parents are not subjected, because of such ownership, to the restrictions of the Bank Holding Company Act of 1956. As you observed earlier, thousands of such institutions have operated for years. Industrial banking institutions, for example, offer chiefly time deposits and make consumer loans and some small business loans. Many are eligible for FDIC insurance. They have increased the competitiveness of consumer financial markets for 7 decades under the laws of more than 20 States, and now number over 1,000 institutions doing business at over 2,000 locations. They have deposits of $4.5 billion and assets of about $7 billion.

These institutions are regulated as financial institutions by the States in which they are chartered, but are not banks under the Bank Holding Company Act, and we are pleased to note, Mr. Chairman, that the recent decision of the tenth circuit in the case that's popularly known as the *Beehive* case, reinforces this fact. We believe this decision correctly interprets the intent of Congress to limit the Bank Holding Company Act's provisions to institutions that accept deposits that the customer has legal right to withdraw on demand.

Now there's another type of consumer bank and in recent years a few diversified institutions have started or acquired small consumer banks with commercial bank charters, not unlike but more limited than industrial banks. They have acquired these institutions for access to funds, for toehold entries into the payments system, to issue credit cards, to avoid overly restrictive and arbitrary State interest limitation, and to compete otherwise in the offering of new consumer financial services. They offer transaction and time deposits, make consumer loans, and have FDIC insurance. Similarly, such companies own State or Federal savings and loan associations.

I thought it might be helpful to outline a few of these institutions that are members of our association. For example, Associates Corporation of North America, a subsidiary of Gulf & Western, operates a national bank and a Federal savings and loan association in California. Among the consumer services offered is a VISA card which provides a refund of 1 percent of all purchases made with the card. A MasterCharge card is offered in conjunction with several national retailers, including K Mart and AT&T phone center stores.

Avco Financial Services, a subsidiary of Avco Corp., is another. Beneficial Corp. participates in the banking industry through a Delaware-based bank. Now this bank, in conjunction with another Beneficial subsidiary, is among the 15 largest issuers of credit cards in the country. Beneficial is the single largest issuer of premium gold MasterCards.

Another major diversified institution, Control Data Corp. is the parent of the Commercial Credit Co., which operates a national bank in Delaware, State-chartered savings and loan associations in Maryland, North Carolina, Ohio, and Pennsylvania, as well as a State-chartered bank in Texas. Now these offices form the basis of a national network offering, among other things, first and second mortgages and are extensively funded by consumer deposits.

The Dreyfus Corp., which recently joined our association, which is a $25 billion mutual fund, started a consumer bank in New Jersey. It is offering automobile loans to consumers at highly competitive rates.

Household Finance Corp., a subsidiary of Household International, owns a national bank and a Federal savings bank in California which offer credit cards and second mortgage loans to their customers.

Sears Savings Bank, a subsidiary of Sears, Roebuck and Co., is over 25 years old and has assets of over $4.5 billion. It offers consumers throughout California a full range of services through its 95 branches.

We could go on, Mr. Chairman, but I believe that this gives you a fairly good picture of the extent to which our members and others have engaged over the years in consumer banking throughout this country. These companies are offering innovative products and services to consumers at competitive prices. The ones listed above serve over 10 million families while providing over $35 billion in consumer credit. They make an important contribution to the Nation's financial services delivery system.

Now in contrast to these consumer services, it has been proposed, and indeed the definition of "bank" in S. 1609 and S. 2134 provides that diversified institutions should not be permitted continued access to the payment system and deposit markets. This is urged even though such activities as evidenced by ownership of State-chartered savings and loan associations and industrial banks have been engaged in by these institutions since the turn of the century.

IDEA THAT NONBANK BANKS ARE UNREGULATED IS ERRONEOUS

A variety of arguments are offered. A contention reported frequently in the popular press that nonbank banks owned by diversified firms are unregulated, is patently wrong. If the institution has a charter issued under Federal or State banking laws—and they all do—it is subject to the same regulation as other banks. These companies already are subject to extensive Federal and State regulation.

Nonetheless, three major arguments have been advanced to support the purported need for new controls over the activities of consumer banks, and these are: (1) Impact on monetary policy, (2) safety and soundness of the financial system, and (3) the possibility of concentration of resources and conflicts of interest that could arise through combining finance and commerce. We also suspect an unspoken fourth one, and that is protection of market and regulatory turf.

These arguments are discussed at length in our prepared submission and I will just briefly summarize here.

Consumer banks, No. 1, are subject to reserve and reporting requirements, as are commercial banks under the Monetary Act of 1980, they have relatively low-risk portfolios consisting of highly diversified, highly liquid assets which generate constant and substantial cash flow, and they are subject to the same restrictions on transactions among money affiliates as those found in section 23(a) of the Federal Reserve Act.

Nonetheless, some observers, even while agreeing that consumer banks are not inherently risky in themselves, still argue that consumer banks affiliated with a nonbank firm somehow subjects the bank to some kind of affiliation risk. Current law and regulations preclude banks from providing deposit-generated funds to affiliates. Thus, any risk which might exist arises not out of the nature of the consumer bank, but out of correctible deficiencies in the deposit insurance system.

Much of the alleged need to control risk through more regulation arises because the deposit insurance system simply misprices risk. Mispricing in the deposit insurance system has the effect of penalizing prudently managed companies that control their own risks, and rewarding those who do not effectively manage risk. As a result, the mispricing of risk invites control through regulation. In the case of consumer banks, the control through regulation approach would exclude all affiliated financial institutions from the marketplace, regardless of the prudence of their risk management. Such an approach is inappropriate since it sacrifices the public benefits of enhanced competition. It would be much better to reform the deposit insurance system by pricing that eliminates subsidy aspects of deposit insurance rather than eliminating the proposed competition.

Finally, the argument advanced against consumer banks is that they might increase concentration of resources or cause conflicts of interest arising from combining commerce and finance. Large-scale industrial/financial conglomerates are sometimes pictured as possible outcomes. There is no evidence of any such trend to warrant such concerns. However, as with the other arguments against consumer banks, this argument does not appear relevant for institutions operating solely in the consumer marketplace. Entry of new firms should bring new capital and make consumer financial markets more competitive, rather than less competitive. Indeed, as we noted at the outset, free right of entry by its very nature tends to combat concentration of resources and conflicts of interest.

We would make this final observation on the consumer bank issue. Technological change is allowing companies to offer new combinations of products, to extend the scope of their current markets and to enter new product and geographic markets.

For consumer financial markets, an important corollary of technical change is the fusing of asset and liability services. Today, new credit products, like revolving credit and credit cards, together with new asset products like automated tellers, debit cards and electronic transfers, are increasingly bringing credit and payment services together.

In the future, joint provision of credit and asset services may become even more important, possibly absolutely essential to our members, and the result is institutions which are frozen out of the asset and payment system aspects of the consumer financial services will be weakened competitively.

Today, about 35 percent or $135 billion of all consumer credit is extended by firms which are not in the payment system. If the need to provide consumer products by a payment system arises, the electronic technology is now at hand to enable these firms to build their own networks. If so, much of the present perceived need to be in the banking system will be moot.

Two other points, Mr. Chairman, I'll briefly summarize. AFSA members, which include the financing affiliates for automobile manufacturers, also are concerned with consumer leasing. We welcome the provision of title V as part of the ongoing reform and we believe the model disclosure forms as proposed by the Federal Reserve Board are much easier to understand for both the consumer and the creditor.

We believe that a few further improvements could be made and we question the need for the disclosure of total lease cost; we discuss this at length in our prepared submission.

Finally, as we have so many times said before in this committee, we believe the interest rate ceilings are a historical anachronism. Congress preempted State rate ceilings on residential mortgage credit in 1980, but the work remains unfinished. Although severe credit shortages in some States' mortgage markets were relieved in 1980, constraints in consumer credit markets live on.

Although market interest rates are not as high today as they were in 1979–82, rather than suggesting that relief is no longer needed, this period of relatively greater financial calm suggests this would be a good time for action before the next crisis causes more severe dislocations. Now is the time to remove ceilings on consumer credit.

Thank you, Mr. Chairman and members of the committee, for this opportunity to express our views.

[The complete statement follows:]

Statement of

ROBERT B. EVANS

President

AMERICAN FINANCIAL SERVICES ASSOCIATION

Mr. Chairman, Members of the Committee, I am Robert B. Evans, President of the American Financial Services Association (AFSA).*

I appreciate the opportunity to appear before you today to present the views of AFSA on S.2181. The Financial Services Competitive Equity Act. We commend the Committee for undertaking this broad review of our nation's financial laws and regulations. Today I will specifically comment on Title I, which would, among other things, authorize establishment and retention of consumer banks that offer financial services to households; Title V, The Consumer Lease and Rental Purchase Act; and Title VII, The Credit Deregulation and Availability Act, which provides for Federal preemption of state usury ceilings on consumer credit.

REGULATION AND COMPETITION

Financial institutions are among the most heavily regulated businesses in the nation's free enterprise economy. For a variety of reasons, financial institutions today labor under many restrictions which include: 1) activity limits, 2) balance sheet requirements, 3) entry restrictions, 4) pricing rules, 5) consumer protection laws, and 6) monetary policy regulations. Hundreds of state and Federal agencies issue regulations, interpretations, guidelines, and enforcement actions.

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* Organized in 1916, AFSA is the national trade association of nonbank bank financial services companies. AFSA represents over 550 companies operating more than 12,400 offices serving the public throughout the country. AFSA membership is highly diversified ranging from single small loan offices to national delivery companies engaged in unsecured direct lending, second mortgage lending, consumer banking, industrial banking and the financing of the sale of durable goods.

Debate over the appropriate role of government in the American financial system is as old as the republic itself. Throughout the country's history an important driving force in this debate has been an inherent fear among Americans about any tendencies toward centralized political or economic power. This concern is manifest today in speculation about whether a handful of private firms will control finance. But what is so often overlooked in these debates and speculation over centralization is that the best antidote to monopoly is not more regulation, but more vigorous competition.

As you know, AFSA stands for competitive financial markets. The benefits of competition in markets are well understood. Nonetheless, they bear repeating because in the heat of legislative and regulatory proceedings they are often overlooked.

First, competition assures that financial products or services are available to those who demand them at minimum production cost. This is the concept of efficiency. Simply stated, competition causes resources to be allocated to their most productive uses with minimum loss of resources along the way. Second, competition reduces potential conflicts of interest and concentrations of power that along with higher prices are found in uncompetitive markets.

To insure these benefits of competition, free entry into markets is an important prerequisite. As soon as substantial barriers to free entry are put in place, the competitiveness of markets begins to deteriorate and the benefits to customers to decline. As competitiveness ebbs, the quality of service declines, the cost rises, or both.

THE CONSUMER BANK

Consumer financial services have been provided for years by thousands of institutions providing a reasonably competitive market in many areas. In this context, Congress - and especially this Committee - should be commended for steps taken in recent years to improve competitiveness of consumer-oriented financial markets. These steps include many of the provisions of the Depository Institutions Acts of 1980 and 1982. We hope the Committee will continue its leadership in this area by adopting legislation advancing the concept of consumer banks.

Historically, consumer financial services have been offered by many types of companies, which often specialize in particular product and geographic markets. Today, technological and communications improvements are lowering the costs of producers. These changes are permitting companies to offer new combinations of products, to extend the scope of their current markets, and to enter new product and geographic markets. Such changes should improve the quality of products and services, and make the markets more competitive.

For consumer financial markets an important corollary of technological change is the fusing of asset and liability services. Whereas at one time consumer credit products (consumer liabilities) were largely distinct from consumer products like deposits and the payment system (consumer assets), this is no longer the case. Today, newer credit products like revolving credit and credit cards, together with new asset products like automated tellers, debit cards and electronic transfers, are increasingly bringing credit and payment services together. In the future, joint provision of credit and asset services may become even more important - possibly absolutely essential. As a result, institutions which are frozen out of the asset and payment system aspects of consumer financial services will be weakened competitively. Currently, over 30% of consumer credit is granted by institutions with no access to the payment system.

Consumer banks have grown to meet these needs. Consumer banks are financial institutions that engage in deposit taking and extension of consumer credit but whose corporate parents are not subjected, because of such ownership, to the restrictions specified in the Bank Holding Company Act of 1956. Thousands of such institutions have operated for years. Industrial banking institutions, for example, offer chiefly time deposits and make some small business loans. Many are eligible for FDIC insurance. They have increased the competitiveness of consumer financial markets for many years under the laws of more than twenty states. The tables in the appendix to my testimony constitute the most complete report on industrial banking in the United States currently available.

The activities and powers of these institutions vary significantly from state to state. In Utah for example, there are 37 industrial loan companies presently holding about $500 million in deposit accounts, and these industrial deposits have recently been increasing at a more rapid rate than those at either commercial banks or savings and loan associations. They are regulated by the state of Utah in the same manner as banks and savings and loan associations. In some areas, such as minimum capital requirements, lending limits, and affiliate restrictions, the laws and regulations governing industrial loan companies are more restrictive than those governing banks or savings and loan associations.

Industrials are primarily consumer lenders but also extend credit to small businesses. Testimony during this Committee's January hearings in Salt Lake City indicated that this type of lending is particularly important because some of the large commercial banks are uninterested in serving the needs of small businesses.

In California and Colorado, industrials are also significant competitors. In other states industrial banks play a less significant role, because they lack the powers necessary to make them viable, competitive institutions. Nationally however, these institutions now have deposit type instruments totaling over $4 billion and consumer and commercial receivables of over $5 billion.

These institutions are regulated as financial institutions by the states in which they are chartered but are not "banks" under the Bank Holding Company Act. The recent decision of the Tenth Circuit Court of Appeals (First Bancorporation v. Board of Governors of the Federal Reserve System, No. 82-1401, Feb. 21, 1984) reinforces this fact. In that case the Federal Reserve Board had asserted that NOW accounts offered by a Utah industrial loan company were demand deposits which, along with commercial lending, made the industrial loan company a "bank" under the Bank Holding Company Act. The Tenth Circuit rejected this argument. Since there was no legal right to withdrawal on demand (Utah law requires the reservation of a right to 30 days notice prior to withdrawal), the NOW accounts were clearly not demand deposits under the federal statute. We believe this decision correctly interprets the intent of Congress to limit the Bank Holding Company Act's provisions to institutions that accept deposits that the customer has a "legal right to withdraw on demand."

Besides industrial banks there also are thousands of other depository institutions which are not governed by the Bank Holding Company Act. Savings and loan associations and mutual savings banks for example, offer transactions and time accounts and make mortgage, consumer, and commerical loans. Most have FSLIC or FDIC insurance.

Services Offered By Consumer Banks

Finally, and causing the most discussion, a few diversified institutions in recent years have started or acquired small consumer banks with commercial bank charters, not unlike but more limited than industrial banks. They have acquired these institutions for access to funds, for toehold entries into the payments system, to issue credit cards, to avoid overly restrictive and arbitrary state interest limitation, and to compete otherwise in the offering of new consumer financial services. They offer transaction and time deposits, make consumer loans, and have FDIC insurance. Similarly, such companies own state or federal savings and loan associations.

These institutions include several AFSA members. For example, Associates Corporation of North America, a subsidiary of Gulf + Western, Inc. operates a national bank and a federal savings and loan association in California. Among the consumer services offered is a VISA card which provides a refund of 1% of all purchases made with the card. A MasterCharge card is offered in conjunction with several national retailers, including K Mart and AT&T Phone Center Stores.

Avco Financial Services, a subsidiary of Avco Corporation, operates a national bank in California which issues credit cards and offers real estate loans to its customers.

Beneficial Corporation participates in the banking industry through a Delaware based bank. The bank, in conjunction with another Beneficial subsidiary, is among the 15 largest issuers of credit cards in the country. Beneficial is the largest issuer of premium "gold" MasterCards.

Commercial Credit Company, a subsidiary of Control Data Corporation, operates a national bank in Delaware, state chartered savings and loan associations in Maryland, North Carolina, Ohio and Pennsylvania, as well as a state chartered bank in Texas. These offices form the basis of a national network offering, among other things, first and second mortgages and are extensively funded by consumer deposits.

The Dreyfus Corporation owns a state bank in New Jersey and a national bank in New York. Dreyfus is offering automobile loans to consumers at highly competitive rates.

Household Finance Corporation, a subsidiary of Household International, owns a national bank and a federal savings bank in California which offer credit cards and second mortgage loans to their customers.

Sears Savings Bank, a subsidiary of Sears, Roebuck and Company, is over 25 years old and has assets of over $4.5 billion. It offers consumers throughout California a full range of services through its 95 branches.

Teachers Services Organization, Inc. owns a national bank in Delaware. Teachers Services specializes in loans by mail and issues credit cards to school teachers, nurses and other professionals.

These companies are offering innovative products and services to consumers at competitive prices and make a positive contribution to the nation's financial services delivery system.

Opposition To Consumer Banks

In contrast to these consumer services, it has been proposed, and indeed the definition of "bank" in S.1609 and S. 2134, provides that diversified institutions should not be permitted continued access to the payment system and deposit markets. This is urged even though such activities as evidenced by ownership of state chartered savings and loan associations and industrial banks have been engaged in by diversified institutions since the turn of the century.

A variety of arguments are offered in support of this restrictive approach to access to the payment system and deposit markets.

The Arguments

Regulation Of Consumer Banks

A contention reported frequently in the popular press - that "nonbank banks" owned by diversified firms are unregulated- is patently wrong. If the institution has a charter issued under Federal or state banking laws, it is subject to the same regulations as other banks. These include: the FDIC Act, the Monetary Control Act of 1980, and the Consumer Credit Protection Act which includes the Truth-In-Lending Act, the Equal Credit Opportunity Act, the Home Mortgage Disclosure Act and the Community Reinvestment Act. National banks are also subject to the National Banking Act, the Federal Reserve Act, and the Glass-Steagall Act (the latter two also govern state-chartered Federal Reserve members). Savings and loan associations are under the

Homeowners' Loan Act and industrial banks are governed by state banking and industrial banking codes. In addition, all of these institutions are subject to antitrust and securities laws. Consequently, it is difficult to conclude that these companies are not already subject to extensive federal and state regulation.

Nonetheless, three major arguments have been advanced to support the purported need for new controls over the activities of consumer banks: 1) impact on monetary policy, 2) safety and soundness of the financial system, and 3) the possibility of concentration of resources and conflicts of interest that could arise through combining finance and commerce. We also suspect an unspoken fourth one, protection of market and regulatory turf.

Monetary Policy Not A Factor

The first argument concerns the banking system as an important element in the transmission of monetary policy. However, the consumer bank issue concerns ownership and affiliations of financial institutions, not essential elements of monetary policy. Consumer banks and savings and loan associations issuing transaction accounts are subject to reserve and reporting requirements in a manner similar to commercial banks. Congress legislated uniformity in this area in the Monetary Control Act of 1980. While ongoing oversight regarding the proper level of reserves, the payment of interest on reserves, the types of accounts on which to require reserves and other technical matters of monetary policy certainly seems reasonable and appropriate, these are not questions raised by the existence of consumer banks. Even if their permissible affiliates may differ under the Bank Holding Company Act, it is not a monetary policy issue. The monetary policy status of commercial banks and consumer banks is exactly the same under the Monetary Control Act.

Safety And Soundness: Consumer Banks Have Low Risk

The second argument concerns the safety and soundness of the banking and financial system. The issue arises because depository institutions are custodians of much of the nation's liquid wealth as well as its payments system. Certainly, everyone agrees that maintaining a safe and sound banking system is a proper role for the government. The ultimate question for consumer banks affiliated with other enterprises is whether they threaten the safety and soundness of the financial system.

Consumer banks by their very nature have portfolios of relatively low risk, high liquidity and widely diversified assets generating a constant and substantial cash flow. In general, consumer credit assets of these institutions are typically characterized by short maturities and reduction of loan balances by monthly amortization payments. They are not subject to sharp fluctuations in market value, and while not saleable instantaneously, the consumer credit portfolio can be sold relatively easily to generate cash. In contrast, typical commercial bank portfolios usually involve larger transactions which may be illiquid and subject to sharper market price fluctuations. The experience of this century demonstrates that the overwhelming majority of consumers repay their debts, even in the worst of economic conditions. The same cannot be said for loans to speculative oil ventures and loans to third world nations.

Section 23A Applies To Consumer Banks

Beyond such normal operating considerations, a consumer bank would be less able than full-line institutions to make commercial loans to affiliates. This fact would tend to enhance currently existing restrictions on transactions among affiliates such as those found in Section 23A of the Federal Reserve Act recently strengthened in the Garn-St Germain Act. Thus it does not seem that safety and soundness concerns are serious enough to argue for wholesale elimination of these consumer-oriented financial institutions from the market for financial services.

Nonetheless, some observers - even while agreeing that consumer banks are not inherently risky in themselves - still argue that a consumer banks' affiliation with nonbanking firms somehow subjects the banks to some kind of "affiliation risk." Current law and regulations preclude banks from providing deposit-generated funds to affiliates. Any risk which might exist arises not out of the nature of the consumer bank, but out of correctible deficiencies in the deposit insurance system. It would make better sense to correct deficiencies in the deposit insurance system rather than to outlaw consumer banks and lose the public benefits of increased competition.

Academic experts, as well as the deposit insurance agencies themselves, have undertaken important reviews of the deposit insurance system. Many of the reforms they have recommended are gradually being implemented.

Much of the alleged need to control risk through more regulation arises because the deposit insurance system misprices risk. Mispricing in the deposit insurance system has the effect of penalizing prudently-managed companies that control their own risks, and rewarding those who do not effectively manage risk. As a result, the mispricing of risk invites control though regulation. In the case of consumer banks the "control through regulation approach" would exclude all affiliated financial institutions from the marketplace, regardless of the prudence of their risk management. Such an approach is inappropriate since it sacrifices the public benefits of enhanced competition. It would be much better to reform the deposit insurance system - e.g. by pricing that eliminates subsidy aspects of deposit insurance - rather than eliminating competition.

The Concentration Issue: Consumer Banks Enhance Competition

The third argument advanced against consumer banks is that they might increase concentration of resources or cause conflicts of interest arising from combining commerce and finance. Large-scale industrial/financial conglomerates are sometimes pictured as possible outcomes. There is no evidence of any trend to warrant such concerns. However, as with the other arguments against consumer banks, this argument does not appear relevant for institutions operating solely in the consumer marketplace. Entry of new firms should bring new capital and make consumer financial markets more competitive, rather than less competitive. Indeed, free right of entry by its very nature tends to combat concentrations of resources and conflicts of interest. While, obviously, the merits of large-scale combination of commerce and commercial banking might be debated much further, it seems that much of the criticism breaks down when focusing on consumer-oriented services.

CONSUMER LEASING ACT

AFSA member companies, which include the financing affiliates of automobile manufacturers, have a major stake in the consumer leasing market. AFSA members engage almost exclusively in long-term closed-end leases subject to the Consumer Leasing Act. We welcome this legislation as part of the ongoing reform and simplification of the Consumer Protection Act. This bill is based upon an initial draft by the Federal Reserve Board staff which is to be commended for its efforts to simplify the present somewhat complicated provisions of the Consumer Leasing Act.

AFSA supports the consumer leasing disclosure simplifications embodied in Title V. We believe the revised model disclosure forms as proposed by the Federal Reserve Board are much easier to understand for both the consumer and the creditor.

We believe that a few further improvements could be made to Title V. First, we question the need for the disclosure of a "total lease cost." This total reflects items that are subject to fluctuation over the term of the lease and urge that this disclosure should be eliminated as it fails to represent the true cost of the lease. In automobile leasing, periodic payments may contain insurance premiums, use taxes and other official fees, all of which may fluctuate over the term of the lease. These variables render the total lease cost disclosure an estimate at best. We note that the Federal Reserve Board's Division of Research and Statistics had argued that this disclosure be deleted.

Second, while the limitation on civil liability would now be more in line with the Truth-in-Lending Act, we believe that criminal liability provisions have no place in the Consumer Leasing Act.

Title V provides a narrow preemption of inconsistent state laws. Because AFSA member companies are generally licensed by the states, or are operating pursuant to state law, AFSA supports the limited preemption in the bill and believe it provides a workable framework for disclosures.

INTEREST RATE CEILINGS

In a competitive economic environment, which we believe that consumer banks enhance, interest rate ceilings are a historical anachronism. Again, we commend this Committee for its efforts on Title V of the Depository Institution Deregulation and Monetary Control Act of 1980 which preempted state rate ceilings on residential mortgage credit. But the work remains unfinished. Although severe credit shortages in some states' mortgage markets were relieved in 1980, constraints in consumer credit markets live on. Market interest rates are not as high today as they were 1979-82. But rather than suggesting that the need for relief no longer exists, this period of relatively greater financial calm suggests this would be a good time for action, before the next crisis causes more severe dislocations.

Interest is the price that those who need additional current resources are willing to pay to have them made available. Interest is paid to those with saved resources they are willing to lend - usually, in our economy, through financial institutions. Thus, financial institutions are conduits or intermediaries that channel resources from savers to borrowers, returning the interest borrowers are willing to pay and which savers require.

In an economy like ours with financial markets and institutions, the price of credit is determined like the price of anything else - by supply and demand in free markets. For any given supply of resources by savers, interest rates will rise if the demand for borrowing rises. Likewise, interest rates will fall if the demand for borrowing falls. Very simply, then, the interest rate at any time is the price of credit that just balances supply and demand. Any deviation of supply or demand from this balance will cause interest rates to move up or down.

In our complex economy with many potential users and borrowers of current resources, there is constant, active competition for funds. And, savers and intermediaries with resources to lend have become more sophisticated. They are not willing to lend to all on the same terms. Instead, they demand different compensation depending on risk, maturity, and costs involved in credit checking, bookkeeping, and operations. Most importantly, they also demand compensation for expected inflation. If prices of goods and services in the economy are expected to rise 6 percent in a year, suppliers of current resources are hardly likely to supply them for a 3 percent rate of interest. Rather, they will require an inflation premium on top of their usual interest requirement. If, for example, their requirement for lending in a noninflationary economy is 5 percent, then if prices are expected to rise 6 percent a year, resource providers will logically require 11 percent annual compensation. This is apart from the need to cover operating costs and the cost of risk.

Now, what has caused the recent high interest rates in the American economy? The answer is twofold - both, unfortunately, dependent on aspects of Federal policies that have developed over many years.

First of all, the Federal government's demand for funds has been almost insatiable in recent years. The desire to increase spending faster than revenues has caused tremendous Federal demands on credit markets. While large deficits could be financed without raising rates if savings expanded sufficiently, the mammoth size of recent and projected deficits has made this difficult indeed.

Second, Federal government policies have led to inflation. Although the situation has improved somewhat in the past year, government spending more than it receives, while financing part of the difference by printing new money, produced domestic inflation. In turn, high and long-rising inflation created inflationary expectations. In this environment savers simply wanted higher interest rates before they were willing to lend resources.

Now, with this background, the next question is what is the impact of usury laws? Interest rate ceilings, of course, are not a new idea and so history can be a guide. Rate ceilings were tried as long ago as the Babylonian Code of Hammurabi and in ancient Greece and Rome. Rate ceilings were common in Medieval Europe until emerging commercial activity overcame them, and some American states still maintain consumer credit rate ceilings today. The clearest message that emerges from 4400 years of experience is that interest rate ceilings distort credit flows to the disadvantage both of borrowers and savers. This fact was highly visible in the collapsing mortgage markets and the rise of the money market mutual funds before passage of the Deregulation Acts in 1980 and 1982. The impact on consumer credit markets is analogously constraining, although maybe not so dramatically visible.

Very briefly, the impact of any below-market price ceiling is not to reduce the price of goods or services, but to create a shortage at the artificial price. One's memory need not be very long to remember the shortages and gas station lines when gasoline prices were controlled. The same thing occurs in credit markets when below-market ceilings are the rule. Below-market prices encourage demand but limit supply, causing shortages to occur. There would be little comfort in knowing that the price of credit is controlled if there is no credit available at that price. The argument that lenders would have little choice but to lend anyway at below-market rates simply is unsupportable. Non-price rationing would result, impacting most severely the younger, less affluent, and more disadvantaged segments of society. Further, savers will merely turn to other - unregulated - markets in which to invest their assets: equities, real property, and precious metals, to name a few.

In sum, there is nothing to recommend retention of interest rate ceilings on consumer credit. Controls have straight-jacketed credit markets for thousands of years. They limit consumers' access to credit and complicate their financial affairs. Mortgage rate ceilings were removed in 1980 improving funds flows in those markets. Now is the time to remove ceilings on consumer credit.

Thank you Mr. Chairman and Members of the Committee for this opportunity to express our views.

Appendix A to Testimony of the American Financial Services Association

The term "industrial bank" is used generally to include those institutions which are chartered by state law to extend installment credit to consumers and small businesses and to accept some form of savings deposit or sell investment certificates or certificates of deposit as at least a partial means of financing the operation. They generally do not, however, accept demand deposits. These institutions are variously referred to as industrial banks, industrial loan companies, thrift and loan companies, loan and investment companies, industrial savings banks, and still more titles. As will be discussed below, the term "industrial" in the names of these institutions historically referred to the fact that their primary purpose was to make loans to industrial workers (not to the industries themselves) and in fact this consumer orientation has remained the focus of most industrial banking insitutions today (see Table 4 of this Appendix).

Currently, there are over 1,000 such institutions operating more than 2,000 locations. They have approximately $7 billion in assets and $4.5 billion in various thrift instruments and deposits. They operate in over 20 states subject to various regulations and conditions (see Tables 1-4 of this Appendix).

Industrial banks trace their origin to 1910 with the formation by Arthur J. Morris of the Fidelity Savings and Trust Company in Norfolk, Virginia.

As they developed during the 1920's,industrial banks were permitted under their charters, in some states, to accept "deposits", and in other states, to issue certificates of "indebtedness" or "investment".

Industrial banks were known and understood nationally when the Banking Act of June 16, 1933 amending the Federal Reserve Act with regard to membership inserted the words "...including Morris Plan Banks and other incorporated banking institutions engaged in similar business." *

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* Section (9) of the Federal Reserve Act, regarding membership, refers to these organizations, as follows:

"Any bank incorporated by special law of any State, or organized under the general laws of any State or of the United States, including Morris Plan banks and other incorporated banking institutions engaged in similar business, desiring to become a member of the Federal Reserve System, may make application to the Board of Governors of the Federal Reserve System, under such rules and regulations as it may prescribe, for the right to subscribe to the stock of the Federal Reserve Bank organized within the district in which the applying bank is located ..." 12 U.S.C. 321.

They were well known in 1940 when Industrial Banking Companies and Their Credit Practices, by Raymond J. Saulnier, was published by the National Bureau of Economic Research. Professor Saulnier observed (p.42) that: "At the end of 1938 there were 71 FDIC-insured industrial banking companies, located in the following states: Alabama, Delaware, District of Columbia, Florida, Georgia, Illinois, Kentucky, Maryland, Michigan, Missouri, New York, North Carolina, Ohio, Pennsylvania, Tennessee, and Virginia. The vast majority of these FDIC insured industrial banks took on full bank charters following the 1940's. The industrial banking companies not FDIC insured, in some of these states and in many others, concentrated on consumer lending and obtained a part of their funds from the sale of certificates of investment or certificates of indebtedness. However, in some states they ceased operations and the laws were amended to delete references to industrial banks. In other states the statutes became obsolete.

National interest in industrial banks as distinct institutions was aroused following the Bank Holding Company Act Amendments of 1970. The Act permitted bank holding companies to acquire and control nonbank subsidaries as long as the subsidiary was engaged in "activities closely related to banking or managing or controlling banks." Among the permitted activities (paragraph 225.4 of Federal Reserve Regulation Y) was "...operating as an industrial bank, Morris Plan Bank, or industrial loan company, in the manner authorized by state law so long as the institution does not both accept demand deposits and make commercial loans." Following the issuance of Regulation Y, many bank holding companies acquired finance companies, some of which had subsidiary industrial banks.

As the cost of funds continued the upward climb that had started in the mid-1960's, and intervals of capital shortages appeared, industrial banks looked more and more attractive as vehicles for obtaining a steady flow of consumer funds to be used for lending to consumers and small businesses. Since most states did not permit industrial banks to take "deposits" it became common practice for them to obtain permission to issue thrift certificates in passbook form, in effect a form of savings deposit.

Major changes in the eligibility of industrial banks for FDIC insurance were brought about by President Reagan's October 15, 1982 signing of the Garn-St Germain Depository Institutions Act of 1982. Specifically, Title VII, Section 703 of the Act addressed this issue directly:

Part (a) of Section 703 extended eligibility for FDIC insurance to include "industrial bank(s) or similar financial institution(s) which the Board of Directors finds to be operating substantially in the same manner as an industrial bank." Previously, eligibility had been specified only for institutions chartered and considered "banks" in their state of charter. By broadening the definition of "state banks" to include "industrial banks and similar institutions," the 1982 Act makes these institutions explicitly eligible for FDIC insurance.

Part (b) of Section 703 expands the definition of "deposits" in the Federal Deposit Insurance Act to include the deposit-like instruments generally used by industrials, which were not previously designated as "deposits." The inclusion of "thrift certificate, investment certificate, certificate of indebtedness, or other similar name" as "deposits" is consistent with the inclusion of industrial banks and industrial loan companies in the definition of "state bank." To implement FDIC insurance eligibility for industrials, paragraph C of Section 703 states that:

> "Before approving the application of any industrial bank or similar financial institution, the Board of Directors shall determine that it is chartered and operating under laws providing for examination, supervision, and liquidation substantially comparable to those applicable to banks operating in the same state."

Industrial banking companies are in most states subject to various reserve, deposit insurance, capital, reporting, supervision and examination requirements. These requirements are generally the same as or similiar to those for commerical banks and other depository institutions.

Following enactment of the above-mentioned provisions of the Garn-St Germain Act, industrial banks in several states, including Colorado, Florida, Hawaii, Nebraksa, Utah and West Virginia have applied for and received FDIC insurance. In addition, some state statutes have been amended to require FDIC insurance for certain types of industrial banking institutions.

Table 3 of this Appendix shows the designation of deposits and deposit-like instruments used in each of the states for the institutions in this report generically described as industrial banks. Savings and time deposits are or can be accepted by institutions in Colorado, Florida, Minnesota, North Carolina, Rhode Island, Tennessee and West Virginia. Other evidences of indebtedness of similar nature to savings deposits are found in other states. By state law these evidences may not be identified as "deposits," though they may be accompanied by a "passbook" which permits the individual to deposit and withdraw money in a thrift account. Short-term investment or thrift certificates frequently offer this feature to the account holder.

Only Rhode Island has authorized industrials to issue demand deposits, and prior approval must be obtained from the Department of Business Regulation.

Deposit insurance requirements are in effect in most states where industrial bank-type institutions operate. In other states independent insurance arrangements have been made. Table 3 details the status of deposit insurance in the various states.

The newly confirmed status of approved industrial banks as Federally insured depository institutions raises questions as to whether they now fall under the provisions of the 1980 Depository Institutions Deregulation and Monetary Control Act (DIDMCA 80) which govern required reserves. The Federal Reserve staff has taken the position that the regional Federal Reserve Banks will notify the financial insitutions which they believe are covered. State-enforced reserve requirements are also detailed in Table 3, as are requirements for capital and branching authorization, where applicable.

Table 1. **Industrial Banking Industry by State 1/**

	As of:	Number of Companies	Number of Locations	Total Assets ($000)
Arkansas	12/82	3	3	33,364
California	12/82	86	644	1,592,361
Colorado	12/82	154	154	916,316
Connecticut	12/83	0	0	0
Florida	12/82	3	3	32,519
Hawaii	12/82	78	231	1,297,455
Indiana	6/82	5	18	303,426
Iowa	12/82	56	201	483,027
Kansas	12/83	11	43	139,339
Kentucky	6/83	28	110	56,272
Minnesota	12/82	28	143	317,985
Missouri	12/82	2	2	10,548
Nebraska	12/82	36	36	389,283
Nevada	12/82	6	21	141,458
North Carolina	6/83	1	1	5,897
Rhode Island	12/82	11	23	627,454
Tennessee Industrial Banks	12/83	0	0	0
Tennessee Industrial Loan & Thrift Companies	12/83	422	422	NA
Utah	12/82	56	110	605,140
Washington	12/82	26	189	279,993
West Virginia Industrial Loan Companies	12/82	68	85	127,512
West Virginia Industrial Banks	12/83	2	2	17,905
Total		1,082 *	2,441	7,377,254

1/ Companies with authority to issue deposits or deposit-like instruments, which may carry a variety of titles. In some states, not all companies with this authority have chosen to do so. The following are figures for those institutions that do issue deposits or deposit-like instruments, in states where a distinction exists:

	As of:	Number of Companies	Number of Offices	Total Assets ($000)
California	12/82	67	621	NA
Colorado	12/82	147	147	898,666
Hawaii	12/82	NA	NA	NA
Iowa	12/82	18	NA	27,362 e
Kentucky	12/83	NA	NA	NA
Minnesota	9/83	6	23	141,107
Tennessee (Industrial Investment Companies)	12/83	27	27	NA
Utah	6/83	37	91	637,064
West Virginia	12/82	NA	NA	NA

* This total number of "companies" is not truly additive, as it represents the numbers of institutions as they are counted by State authorities. In various states where branch banking is prohibited, for example several separately chartered institutions that are owned by one holding company are reported as separate "companies" while in branch banking states a similar group would count only as a single "company".

NA: Not available.

e: estimate

Table 2 **Comments on Status of Industrial Banking Industry by State**

Arizona:	Due to lending restrictions (on rate and size of loans), no industrial banks are in operation. No new charters will be granted.
Arkansas:	Arkansas Industrial Loan Companies (ILC's) obtain the majority of their funds from consumer sources, namely from certificates of investment. In mid-1983, for all ILC's combined, such certificates constituted 98% of total liabilities and 90% of liabilities and capital combined. No new industrial loan company charters are available.
California:	The number of California Industrial Loan Companies and the number of offices increased in 1982 by 31% and 25% respectively. Total assets, loans, and investment certificates outstanding have grown steadily over the past ten years, with the largest increases occurring in 1982, when both total assets and investment certificates outstanding grew by 31%. The health of the industry is largely attributable to the broad lending powers of the companies. Unlike some states, industrials in California are considered an important source of capital for business. Investment Certificates constitute a high proportion of liabilities at Industrial Loan Companies in California. The composite statement of condition at the end of 1982 shows certificates of investment as 90% of liabilities and as 80% of liabilities and capital.
Colorado:	The Colorado Industrial Bank Law is an old law which allows the institutions to offer nearly all consumer deposit services that commerical banks offer, including the recently added NOW accounts. Demand deposits are not authorized, however. The number of institutions has grown steadily, from 80 in 1975, for example, to 154 in 1982. Six new industrial banks were chartered in 1982. Industrial Banks are full-fledged financial institutions and obtain funds from many sources. Deposits and certificates thus account for just 40% of liabilities and capital.
Connecticut:	No Industrial Banks have been in operation since 1971. Current law would permit establishment of de novo banks, but lending (rate) restrictions make industrial banks a relatively unattractive alternative to other financial institutions.

Florida:

There are only 3 Industrial Savings Banks in operation in Florida, but there has been considerable interest in gaining access to the deposit market there. Although new charters are technically avilable, the Comptroller has been reluctant to approve applications submitted by three out-of-state bank holding companies for industrial savings bank charters. Litigation is currently in process.

Florida's Industrial Savings Banks (ISB's) have no thrift or investment certificates outstanding because they have broad deposit-taking authority. Time & savings deposits gathered under this authority provide almost all of the liabilities of the ISB's.

Hawaii:

Although not all Industrial Loan Companies in Hawaii offer thrift certificates, balance sheet information is available only for the thrift-issuing and non-issuing companies combined. This information does, however, reveal some alterations in the structure of liabilities following a few recent failures. In December, 1980, "borrowed money" constituted 25% of total liabilities and investment certificates were 45%. In June 1983, the same ratios were almost reversed, at 45% and 29%. Total Liabilities were $1,002 million and $1,581 million for the two years respectively. Also of significance is the decline during the most recent year of the dollar amount loaned to the industrials in the form of investment certificates, from $508 million to $460 million.

Companies that offer certificates will, as of June 30 1984, be required to have FDIC insurance.

Indiana:

Between 2% and 13% growth in total assets has taken place in the industrial loan industry in Indiana in each of the past 6 years, but has been limited due to the prohibition on entry by new firms. Total assets grew 9.4% from June 1981 to June 1982. Certificates of investments make up about 90% of total liabilities and capital.

Iowa: There has been a general consolidation of Iowa's Industrial Loan Companies in the past several years. Currently, there are 18 deposit-taking companies and 38 non-deposit-taking companies. While balance sheet information is available only for the total, the 18 deposit-taking companies represent about 45% of activity in Iowa. Although net losses have occured between 1980 and 1982, the outlook for 1983 and beyond (as reported in the State Auditor's report) was for revived growth and earnings performances. Total assets at all reporting companies grew 2% in 1982, while long-term investment certificates decreased (by $3.7 million) and short-term certificates grew (by $30.4 million). Investment certificates overall grew 15% in 1982, to a total of $208.1 million of which $24.6 million was long term and $183.5 million short-term.

Kansas: Kansas permits loan companies to issue certificates of investment under the Kansas Investment Company Act. They are not called "industrials" in any way, and the certificates are distinguishable from those issued by industrials in that they are treated as securities.

Kentucky: Kentucky's Small Loan law was changed in July 1982 to enhance the lending powers of Small Loan Companies and increase permitted loan sizes. Industrial Loan Companies are authorized only to make smaller loans, which are now less attractive to borrowers than those available at Small Loan Companies. There has subsequently been a substantial decrease in the number of Industrial Loan Companies operating. Whereas in June, 1981 there were 45 state-chartered Industrial Loan Companies operating 221 offices, in June 1983 those numbers had declined to 28 companies and 110 offices.

Maine: In the early 1970's there were only a handful of industrial loan companies operating in Maine, all of which had closed by 1974. Rate restricitons have limited consumer finance activity in general in the state, and no new industrial bank charters will be issued.

Massachusetts: Michigan	Both Massachussets and Michigan have previously had industrial banking laws, but all operations in these states have ceased and no new charters are available.
Minnesota:	In July 1983, Industrial Loan and Thrift Companies were granted authority to apply for deposit-taking powers (see Table 3). As of September 1983 six of the 28 Industrial Loan and Thrift Companies had such approval, which companies held about 40% of the combined total assets of all 28 companies. Their deposits were in the area of $50 million. Deposits are required to be insured, by an approved insurer, up to $100,000 per account. All of the deposit-taking companies now have independent deposit insurance. While neither these deposits nor thrift certificates outstanding independently constitute more than 50% of total liabilities of the industry, the combined total makes up 88% of liabilities.
Missouri:	Lending restrictions limit the attractiveness of operating Loan & Investment Companies. The few that do operate have been in existence since approximately the 1920's and are almost exclusively consumer-oriented in both their assets and liabilities. 80% of liabilities are in the form of investment certificates.
Nebraska:	The previously stable Industrial Loan and Investment companies have experienced considerable difficulties related to the collapse in October 1983 of Commonwealth Savings Company, one of the largest industrials in the state. Approximately $70 million in deposits at Commonwealth were insured by the Nebraska Depository Institutions Guaranty Corporation (NDIGC), of which the fund was able to cover only $2 million. Since all industrials in Nebraska were previously required to be insured by the NDIGC, and the fund is technically still in existence but has no free assets, the Department of Banking and Finance has encouraged those institutions to seek other deposit insurance, preferably at the Federal level. There is currently a legislative effort to enact a bill to require all financial insititutions to have federal insurance. Many, if not most of the companies have obtained FDIC

Nebraska Continued:

insurance, some have obtained private insurance, and others have taken steps to change their charters to other types of financial institutions such as credit unions, S&L's, state banks, etc. There have also been consolidations of several industrials, probably anticipating some loss of consumer confidence in the institutions following the Commonwealth failure. Prior to these events, certificates of investment have been the major type of liability held by Nebraska's industrials. They constituted 94% of total liabilities according to statements of condition at the end of 1982. While some change can be anticipated in statements at the end of 1983, these data are unavailable at time of printing.

Nevada:

The industrial loan industry in Nevada is another true "thrift" industry, thrift certificates at the end of 1982 making up about 90% of liabilities and capital. The Department of Financial Institutions reports "remarkable" growth in the industry throughout the 1980's. While total assets have grown from $53 million in 1979 to $142 million in 1982, certificates outstanding have grown from $47 million to $128 million. A report of the Department, published before release of 1982 data, had stated:

> "It is possible (however,) that a growth plateau has been reached as some industry spokesmen believe that with the lifting of most usury restrictions and with the advent of deregulation, and with the public more aware that thrifts are not insured as are banks and S&L's, thrifts no longer have their original appeal."

Such a slowing and loss of appeal does not yet appear to have taken place.

North Carolina:

The only currently existing institution in North Carolina has been in operation for about 65 years. The Commissioner's office has recently received application(s) for new charters and, while there have been delays in processing, new charters are available.

Oklahoma:

While Oklahoma law specifically prohibits chartering of industrial banks, there are institutions chartered as Trust Companies which sell securities and otherwise operate as what might elsewhere be classified as industrial banks.

Rhode Island:

The Rhode Island Loan and Investment Company charter is one of the most liberal charters under which industrial bank-type institutions operate. The companies have recently been granted authority to use the word "bank" in their names (with approval of the Department of Banking) and can now be considered "Banks" under Rhode Island Law. (None of the companies have as yet incorporated the word "bank" into their names.) Deposit-taking and lending powers are as extensive as those of state and national commercial banks, credit unions and the like, and their investment powers are broader than those of some other institutions. In addition, the option to hold private deposit insurance, as opposed to FDIC deposit insurance required for other depository institutions has allowed them (prior to elimination of Regulation Q deposit interest rate ceilings) to attract deposits by paying slightly higher rates.

In the past 2 years there has been a tremendously successful effort by most of the Loan and Investment Companies to gather deposits. Accordingly, statements of condition for December 1980 and 1982 show an increase in total deposits from $70 million to $218 million, an increase of 213%. Deposits and certificates made up 97% of total liabilities at the end of 1982. Investment certificates have grown 60% from $217 million to $348 million also. Aggregate capital, surplus and undivided profits have increased in absolute terms from $36 million to $43 million, but have decreased as a percent of total liabilities and capital from 8.2% to 6.7%. Total assets increased 48% from $435 million to $641 million.

Tennessee:

Significant changes in the industrial loan laws of Tennessee have been made since the failure of a Butcher-controlled institution in 1983.Those institutions which had been "Industrial Loan and Thrift Companies" and sold certificates of investment but could not accept "deposits" were required to convert to "Industrial Investment Companies." Those certificates are now securities rather than deposits. This conversion assigned some regulatory authority to the Department of Securities and thereby allowed a change (increase) in required capital. Currently, 4 companies have converted, and operate at 27 locations (In the footnote on Table 1, 27 "companies" are listed in order to make the entry consistent with the way the number of industrial Loan and Thrifts is counted by the State).

For those Industrial Loan & Thrift Companies not offering certificates, no change wasrequired. In these cases, however, "Thrift" is a misnomer, as they offer none. There are currently approximately 422 such companies, of which the Industrial Investment companies are also considered Loan & Thrifts.

Tennessee law also authorizes "Industrial Banks" and requires FDIC insurance for any such bank. There are currently no Industrial Banks in operation.

Utah:

Although there are 56 Industrial Loan Corporations in Utah, only 37 of these offer thrift accounts, either in certificate or savings account form. These 37 companies hold most of the assets of all 56 companies combined. Thrift certificates are a major source of funds, and constitute 88% of total liabilities and 74% of total liabilities and capital at the thrift-issuing institutions.

Virginia:

There is no industrial banking law in Virginia. The Industrial Loan Associations that do exist engage only in lending activity and are not licensed to take any deposits or offer deposit-like instruments. There are currently 12 Associations in operation. These are primarily engaged in consumer and mortgage lending business and either hold receivables or act as brokers.

Virginia Continued:

Growth has been non-existent since 1979 at these companies, total assets hovering between $18 and $19 million 1980-82, after falling from a $21 million level in 1979.

Washington:

The Industrial Loan Companies in Washington operate like traditional Morris Plan institutions which in many other states have evolved into industrial banks. The Washington institutions are prohibited by statute from taking deposits or creating any liabilities on demand. Like the old Morris Plan banks, they make consumer loans which are repayable in installments to hypothecated investment certificates. The primary purpose of Industrial Loan Companies is to lend to workers in industry, hence their name.

Growth in this industry has been greater in the 1980's than in previous decades,total loans having grown 125%, 247% and 98% during 1980, 1981 and 1982 respectively . Payments on hypothecated investment certificates have grown 21%, 102% and 144% for the same periods, and total assets 193%, 149% and 91% (See Table 4 for current dollar values). 99% of the loans outstanding shown in Table 3 are secured by hypothecated investment certificates. Payments on these certificates, however (shown as "Thrift or Investment Certificates" in Table 4) do not constitute a large part of liabilities.

West Virginia:

There are two types of institutions that operate under the Industrial Loan Law in West Virginia. Industrial Loan Companies, of which there are currently 68, are corporations formed with the approval of the Commissioner of Banking. They are authorized to sell evidences or certificates of indebtedness, but are prohibited from taking deposits. (Not all of the 68 companies actually sell evidences of indebtedness however.) Industrial Banks are, by contrast, depository institutions formed with the approval of the Board of Banking and Financial Institutions. They are banking institutions (unlike Industrial Loan Companies) and are authorized to accept true deposits. There are only 2 industrial banks in West Virginia, presumably because the industrial bank charter carries restrictions beyond those in effect for full bank charters, and thus offers no advantage over a regular bank charter. There appears to be very little functional difference betwen the two types of insitutions, although there is legal distinction between deposits at industrial banks and nondeposit evidences of indebtedness at industrial loan companies.

Table 3. Powers of Industrial Banking Institutions by State

State & Supervisory Authority	Designation of Institutions	Deposit-Taking Authority	Lending Authority	Reserve Requirements
Arkansas Bank Commissioner	Industrial Loan Institutions	-Investment Certificates in Passbook form -Investment Certificiates	May lend money on the collateral deposit of and terms of investment certificates.	15% of investment Certificates
California Commissioner of Corporations	Industrial Loan Companies	-NOW accounts -Deposits -Investment Certificates -Investment Certificates in receipt book form -(Hypothecated Investment Certificates)	-Investments as allowed for commercial banks -Secured or unsecured lending -Purchase, sale or discount of trust receipts, Choses in Action, conditional sales contracts, security agreements	At discretion of Commissioner.
Colorado Banking Commissioner	Industrial Banks	All consumer deposits as authorized for commercial banks except for demand deposits. Includes: -Passbooks -Thrift investment certificates -NOW accounts -Other time deposit accounts	-Consumer lending as authorized for commercial banks -Commercial lending	15% of deposits

Capital Requirements	Deposit Insurance Requirements and Provisions	Branching and Licensing Provisions and Requirements	Other
Arkansas			
By population: -Under 6,000=$50,000 -6,000-50,000=$100,000 -Over 50,000=$200,000	Uninsured, no insurance requirement		At least 5 persons may form a corporation - all must be residents.
California			
$750,000 paid-in plus $500,000 surplus plus $50,000 per branch (Different for companies established before July 9, 1975. May change with change in ownership.)	Membership in Thrift Guarantee Corporation of California. Coverage up to $10,000 per account, or to $50,000 by order of Commissioner, unless thrift accounts are insured by an instrumentality of the U.S. Government.	Certificate of Authorization required	
Colorado			
By population: -Under 25,000=$300,000 paid in plus 20% surplus and 10% undivided profits -Over 25,000=$500,000 paid in plus 20% surplus and 10% undivided profits	Either FDIC insurance or Colorado Industrial Bank Savings Guaranty Corporation insurance required for institutions which take deposits -$100,000 per account at FDIC -$20,000 per account at CO IB per account Savings Guarantee Corporation	Not permitted	

State & Supervisory Authority	Designation of Institutions	Deposit-Taking Authority	Lending Authority	Reserve Requirements
Florida				
Commissioner of Banking	Industrial Savings Banks	-Time Deposits -Savings Deposits -Passbook accounts -NOW accounts -Investment Certificates Commercial or demand accounts are prohibited.	Investments as permitted for commercial banks including: -1st Mortgage -2nd Mortgage -Personal Loan -Revolving Credit -Revolving Sales -Sales	15% of deposits
Hawaii				
Bank Examiner	Industrial Loan Companies	-Passbook accounts -Investment Certificates	Unsecured or secured lending, secured by real estate, personal property or Choses in action	-5% of liabilities on certificates and debentures with maturities over 1 year -7% of liabilities on certificates and debentures with maturities of less than one year.
Indiana				
Department of Financial Institutions	Industrial Loan and Investment Companies	-Certificates of Investment or Indebtedness -Certificates in passbook form -NOW accounts	May loan money for personal and commercial purposes	3% of paid in amount on outstanding certificiates

Capital Requirements	Deposit Insurance Requirements and Provisions	Branching and Licensing Provisions and Requirements	Other
Florida			
$400,000 plus paid-in surplus of 20% of paid-in capital; plus undivided profit of 5% of paid-in capital	-2 of 3 institutions currently have FDIC insurance Deposit insurance is required for all newly formed banking institutions, including ISB's.	Branching within the country is permitted	
Hawaii			
-$300,000 minimum for thrift-issuing companies -$100,000 minimum for non-issuing companies	Formerly membership Thrift Guarantee Corporation of Hawaii was required. The fund was largely depleted during 1982. FDIC insurance will be required as of 6/30/84, thereafter no institution can issue thrift without such insurance.	Individual Branch Licenses required.	
Indiana			
$50,000	None required FDIC authorized	(Branches exist)	No new charters available since repeal of authorization in 1935.

State & Supervisory Authority	Designation of Institutions	Deposit-Taking Authority	Lending Authority	Reserve Requirements
Iowa				
Auditor of State	Industrial Loan Companies	-Passbook accounts -Certificates of Indebtedness	-Small size limits in effect until 7/83 -Real estate loans -Iowa Supervised consumer loans (generally consumer lending: fixed-term or open-end). -Lending for corporate purposes, unsecured or secured by real or personal property.	None
Kansas				
Consumer Credit Commissioner	Investment Companies	No deposit-taking authority. Investments Certificates are not deposits -Investment Certificates -Passbook Investment Certificates	Investments only inherent in the principal business of the investment company - generally consumer finance transactions.	10% of deposits
Kentucky				
Department of Banking and Securities	Industrial Loan Companies	No deposit-taking authority. Certificates of Investments are securities not deposits, and must be registered with state and federal securities agencies	Loan of up to $10,000 in the same manner and at the same rate as that authorized for banks. Includes second mortgages.	5% on Certificates of Investment

Capital Requirements	Deposit Insurance Requirements and Provisions	Branching and Licensing Provisions and Requirements	Other
Iowa			
By population: -Under 25,000=$25,000 Plus 10% surplus -Over 25,000=$50,000 Plus 10% surplus	Membership in Industrial Loan Thrift Guaranty Corporation of Iowa (established 3/81) is required if certificates have been issued. Accounts are insured up to $10,000 per account.	Licenses required for each office	
Kansas			
$150,000	Kansas Investment Certificate Guarantee Corp. Accounts to be insured up to $10,000.	(There are branches)	
Kentucky			
-$100,000 in counties with "cities of the first or second class" -$50,000 in other other counties	NA	(branches exist)	

State & Supervisory Authority	Designation of Institutions	Deposit-Taking Authority	Lending Authority	Reserve Requirements
Minnesota				
Commissioner of Banks	Industrial Loan and Thrift Companies	-Certificates of Indebtdness -Savings accounts or savings deposits (with authorization only) -Demand Deposits and NOW accounts prohibited	Authority is to make loans both unsecured and secured by real and personal property.	Currently 10% of deposits. Thrifts are required to "maintain reserves in the form of liquid assets at a reasonable level.
Missouri				
Commissioner of Finance	Loan and Investment Companies	May not receive money on deposit or engage in banking. -Certificates of Investment or or Indebtedness -Certificates in Passbook form	May lend to individuals or corporations, secured or unsecured.	None
Nebraska				
Department of Banking and Finance	Industrial Loan and Investment Companies	-Certificates of Indebtendess -Fully paid -Installment -Certificates in Passbook form.	-1st Mortgage -2nd Mortgage -Personal Loan -Sales -installment loans	-3% of Certificates -10% of Passbook accounts

Capital Requirements	Deposit Insurance Requirements and Provisions	Branching and Licensing Provisions and Requirements	Other
Minnesota			
By population: -Under 50,000=$25,000 -50,000-100,000=$50,000 -Over 100,000=$75,000 Plus: At least 10% of required capital in paid-in capital	Insurance to $100,000 per account required as of 7/1/83. Currently all thrift-issuing companies are privately insured. (Although they may be eligible for FDIC insurance.)	(branches exist)	Banking Department will not grant permission to issue thrift until insurance available.
Missouri			
Same as for general business corporations.	None		May not receive money on deposit or engage in banking.
Nebraska			
By population: -Under 2,500=$100,000 -Under 25,000=$150,000 -Under 100,000=$200,000 -Over 100,000=$550,000 Plus: -50% of capital in surplus -20% of capital in undivided profit	As of July 1, 1983 deposit insurance was required. Federal level insurance is encouraged for all financial insitutions. (See Table 2)	Branching prohibited	

State & Supervisory Authority	Designation of Institutions	Deposit-Taking Authority	Lending Authority	Reserve Requirements
Nevada				
Department of Commerce, Financial Institutions Division	Thrift Companies	May not receive deposits or issue certificates of deposit. -Thrift Certificates which must carry disclaimer: "This is not a Certificate of Deposit" -Thrift Certificates in Passbook form	-Investments as permitted for savings institutions -Loans secured by real or personal property.	A Liquidity Reserve Requirement has recently (July 1983) replaced a prior requirement of a $1 million bond. Reserves eventually to equal 1.5% of deposits.
North Carolina				
Commissioner of Banks	Industrial Banks	-Time and Savings Deposits -Certificates of Deposit	As for Commercial banks	
Rhode Island				
Department of Business Regulation (Banking) Division)	Loan and Investment Companies or Loan and Investment Banks	-Full deposit-taking authority, although approval must be obtained to take demand deposits. -Investment Certificates -Fully paid -Partly paid are not deposits.	-Full lending authority consumer and commerical lending (as for banks.)	15% on deposits

Capital Requirements	Deposit Insurance Requirements and Provisions	Branching and Licensing Provisions and Requirements	Other
Nevada			
-At least $250,000 start-up and $25,000 for each office Plus: -20% of paid-up capital in surplus -10% of paid-up capital in undivided profit (Undivided profit required only if the institution has had sufficient earnings.)	Thrift Certificates must state in a disclaimer that they are uninsured.	Administrator's approval required for branches.	Out-of-State banks and S&L's and Nevada Installment Loan and Act Licensees prohibited from obtaining thrift licenses.
North Carolina			
50% of that required for Commercial banks, as follows: By population: -Under 3,000=$50,000 -Under 10,000=$75,000 -Under 25,000=$100,000 -Under 50,000=$125,000 -Over 50,000=$150,000 Plus: -Paid-in surplus of at least 50% of capital stock	FDIC or private deposit insurance	With permission of Commissioner.	Provision relating to supervision and examination of commercial banks is applicable to industrial banks.
Rhode Island			
$1,000,000	FDIC or Rhode Island Share Depository Indemnity Corporation insurance to $100,000 per account required.	With approval of Department (all financial institutions are under the same branching rule).	-Recent change (1981) allows Loan & Investments Companies to use word "Bank" in name. -Must also use "Loan" & Investment." -Must get approval from Banking Division to use "Bank"

State & Supervisory Authority	Designation of Institutions	Deposit-Taking Authority	Lending Authority	Reserve Requirements
Tennessee				
Department of Financial Institutions	Industrial Loan & Thrift Companies	None	-loans unsecured or secured by real or personal property -Inventory loans -acceptances, etc. (similar to banks)	NA
	Industrial Banks	As determined in Garn-St Germain Act -Thrift Certificates (must be Federally insured)	same as above	per FDIC
	Industrial Investment Companies	Certificates of Investment are not federally insured. IIC's are subject to examination by the Department of Securities.	same as above	
Utah				
Commissioner of Financial Institutions	Industrial Loan Corporations	-Thrift Certificates -Passbook accounts -NOW accounts -Certificates of Deposits	Consumer and Commercial loans, real estate loans	5% of deposits
Virginia				
State Corporation Commissioner Bureau of Financial Institutions	Industrial Loan Associations	None	-Mortgages -Consumer lending	NA

Capital Requirements	Deposit Insurance Requirements and Provisions	Branching and Licensing Provisions and Requirements	Other
Tennessee			
$25,000	NA		(These are basically non-thrift-issuing finance companies).
Tennessee			
As for state banks	FDIC insurance is required.		
Tennessee			
In keeping with the scope of business as determined by the commission, but not less than that of a comparable Industrial Bank.	No provision. (They seem to be looking into private insurance.)	(branches exist)	
Utah			
By population: -Under 99,000=$250,000 plus $75,000 in surplus -Over 99,000=$500,000 plus $125,000 in surplus. Also: $50,000 for each branch	Insurance is required for Thrift-issuing companies, either from the FDIC or Utah Guarantee Corporation.	Branches must have individual license/charters.	Of 56 Companies in operation, only 37 take thrift. These companies hold 97% of total assets in the (56) Industrial Loan Corporations.
Virginia	NA		See Table 1.

State & Supervisory Authority	Designation of Institutions	Deposit-Taking Authority	Lending Authority	Reserve Requirements
Washington				
Supervisor of Banking	Industrial Loan Companies	None. Hypothecated Investment Certificates issued but are not "deposits". Acceptance of deposits and creation of liability on demand are expressly prohibited.	May lend money, which may include a requirement of borrower to purchase an investment certificate.	5% of payments on Investment Certificates
West Virginia				
Department of Banking	Industrial Loan Companies	May "sell or offer for sale secured or unsecured evidences or certificates of indebtedness"... ..."not authorized to accept deposits." -Certificates must state on their face that they are not federally insured	Authorization is to lend to any person, firm or corporation.	
	Industrial Banks	-May accept "deposits from the public" -checking accounts savings accounts time deposits -Thrift accounts -Certificates of Deposit	Authorization is to lend to any person, firm, or corporation.	-7% of demand deposits -3% of time deposits

Capital Requirements	Deposit Insurance Requirements and Provisions	Branching and Licensing Provisions and Requirements	Other
Washington			
By population: -Under 100,000=$25,000 -Over 100,000=$50,000	NA		
West Virginia			
$25,000	Insurance will be required by 12/31/84 (insurer to be approved by Commissioner) to $100,00 per account	Branch Offices permitted with "Branch Office Certificate" from Commissioner (this is a new power)	-Any number of persons can form Industrial Loan Company. -Regulated by Commissioner (includes Department of Banking) -An Industrial Loan Company may not use the word "Bank" in its name.
As for commercial banks, by population: -Under 3,000=$50,000 -3,000-6,000=$75,000 -6,000-25,000=$100,000 -25,000-50,000=$125,000 -Over 50,000=$150,000	FDIC insurance is required	No branch Industrial Banks are permitted	-At least 5 persons needed to form I.B. -Must all be residents of WV -Name shall be .. "Industrial Financiing Corporation" -Formed with approval of the board of banking and financial institutions

Table 4. Assets, Liabilities and Related Ratios of Industrial Banking Institutions in Selected States

	TOTAL	AR 6/83	CA 12/82	CO 12/82	FL 12/82	HI 12/82	IN 6/82	IA 12/82	KS 12/82	KY 6/83	MN 12/82	MD 12/82	NV 12/82	[illegible] 6/83	NE 12/82	RI 12/82	UT 12/82	WV ILC S 12/82	WV IB S 12/83	[illegible] 12/82
ASSETS																				
RECEIVABLES (NET)	5821499	20771	1397941	748493	19990	1017983	252977	342182	124703	47742	284871	7342	104083	2779	279809	308840	474516	98582	13801	274294
CONSUMER					19900															
COMMERCIAL					90															
OTHER ASSETS	1555755	12593	194420	167823	12529	279472	50449	140845	14636	8530	33114	3206	37375	3118	109474	318614	130624	28930	4104	5699
TOTAL ASSETS	7377254	33364	1592361	916316	32519	1297455	303426	483027	139339	56272	317985	10548	141458	5897	389283	627454	605140	127512	17905	279993
LIABILITIES																				
DEPOSITS	372636	0	0	109018	26828	0	0	0	0	0	0	0	0	4411	0	217968	0	0	14411	0
DEMAND		0	0	0	0	0	0	0	0	0	0	0	0	0	0		0	0	0	0
TIME		0	0	109018	26828	0	0	0	0	0	0	0	0	4411	0		0	0	14411	0
THRIFT INV CERTIFICATES	3953129	30019	1264241	262716	0	489942	271617	208079	48335	10816	49927	6915	126746		335111	348228	387267	52217	0	58953
UNHYPOTHECATED			939269		0		271617				39508				293947				0	
HYPOTHECATED			324972		0		0				10419				41164				0	
OTHER LIABILITIES	1880576	654	140096	408582	170	610644	6783	142099	75977	22100	166483	767	3878	46	15730	18363	113191	23687	718	132608
TOTAL LIABILITIES	6206341	30673	1404337	780316	26998	1100586	278400	350178	124312	32916	216410	7682	130624	4457	350841	584559	500458	75904	15129	191561
TOTAL CAPITAL	1170913	2691	188024	136000	5521	196869	25026	132849	15027	23356	101575	2866	10834	1440	38442	42895	104682	51608	2776	88432
TOTAL LIABILITIES AND CAPITAL	7377254	33364	1592361	916316	32519	1297455	303426	483027	139339	56272	317985	10548	141458	5897	389283	627454	605140	127512	17905	279993
RATIOS																				
LOANS/ASSETS	0.79	0.62	0.88	0.82	0.61	0.78	0.83	0.71	0.89	0.85	0.90	0.70	0.74	0.47	0.72	0.49	0.78	0.77	0.77	0.98
DEPOSITS/L&K	0.05	0.00	0.00	0.12	0.82	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.75	0.00	0.35	0.00	0.00	0.80	0.00
DEPOSITS&CERTIFS/L&K	0.59	0.90	0.80	0.41	0.82	0.38	0.90	0.43	0.35	0.19	0.16	0.66	0.90	0.75	0.86	0.90	0.64	0.41	0.80	0.21
K/L&K	0.16	0.08	0.12	0.15	0.17	0.15	0.08	0.28	0.11	0.42	0.32	0.27	0.08	0.24	0.10	0.07	0.17	0.40	0.16	0.32
CERTIFS/L&K	0.54	0.90	0.80	0.29	0.00	0.38	0.90	0.43	0.35	0.19	0.16	0.66	0.90	0.00	0.86	0.55	0.64	0.41	0.00	0.21
CERTIFS&DEPOSITS/L	0.70	0.98	0.90	0.48	0.99	0.45	0.98	0.59	0.39	0.33	0.23	0.90	0.97	0.99	0.96	0.97	0.77	0.69	0.95	0.31
DEPOSITS/L	0.06	0.00	0.00	0.14	0.99	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.99	0.00	0.37	0.00	0.00	0.95	0.00
CERTIFS/L	0.64	0.98	0.90	0.34	0.00	0.45	0.98	0.59	0.39	0.33	0.23	0.90	0.97	0.00	0.96	0.60	0.77	0.69	0.00	0.31

The CHAIRMAN. Thank you, Mr. Evans.

You presented testimony today that advocates consumer banks being authorized—and I believe I saw you in the audience when the representative of the thrifts were testifying against this new invention, and I think we have adequately covered that whatever people's agreement or disagreement, it is not a new invention because we term it consumer banks rather than industrial loan company or whatever it is.

CONSUMER BANKS GROWTH TREMENDOUS

Have you found that in States they already operate in they have led to undue concentrations?

Mr. EVANS. No; it's just the other way around. In fact, in your State, Mr. Chairman, I note there's a vigorous community of industrial banks and I think they testified at your first hearing earlier this year in Salt Lake that they had actually filled a gap in supplying credit to small business which had been largely ignored by many of the commercial banks in the area, and they also, I might point out, are growing very vigorously, possibly faster than the commercial banking system in Utah.

I'd like to think that this is providing pretty stiff competition for them.

The CHAIRMAN. Well, there certainly hasn't been any concentration in my State and they have been around for a long number of years.

The U.S. League witness specifically argued earlier this morning that ownership by any type of company of a depository institution should be done only when its significant public policy requires it and he then cited housing and ownership of thrifts as an example.

Do you agree with that?

Mr. EVANS. Well, I'm not quite sure what he really means by that "significant public policy." Indeed, it's been the public policy to subsidize a number of activities, particularly housing. I don't think it follows that consumer credit, which is so important for the financing of automobiles, goods, and services in this country, is somehow a stepchild which deserves to be dismissed as unimportant.

I really think it misses the point. We have about $385 billion in consumer credit outstanding today. About 35 percent of this is not handled through the payments system. As I said in my prepared testimony, we think at some point it's going to be necessary to have access to the system to deliver these financial products competitively with those that are in it. I don't think it's so much a matter of getting at the deposit base as it is primarily the delivering of the combination of the products which are going to be offered.

The CHAIRMAN. Your association's members compete with various types of financial institutions in several different areas, such as deposit-taking, loans, credit cards, insurance, securities. Do many cross-sell different kinds of products or do most of them choose to specialize?

Mr. EVANS. I would say at the moment most of them very much specialize. There is a possibility, obviously, of cross-selling, especially where securities and credit extensions are available in the same institution. That's true today in both the banks and the S&L's that have discount brokerage. It's true, I suppose, of the Merrill Lynch cash management account. And I see nothing wrong with this as long as the rules against conflicts are followed.

The CHAIRMAN. You've mentioned specifically that you felt that people would benefit through the additional competition. Now do you believe that competition between your members and banking organizations has resulted in lower loan rates or any other obvious benefits?

Mr. EVANS. No question about it. With the demise of regulation Q, finance companies have become extremely competitive in their rates. I'll give you a good example.

GMAC money costs—that's General Motors Acceptance Corp., which has about $55 billion in assets—their money costs are about 50 basis points less than Citibank's. They can compete aggressively in the automobile sales finance market today. Market rates have become the overall rate.

Credit ratings and credit worthiness of the lender are the determinant today. This gets back to the point I made about mispricing of risks through credit insurance. This subsidy is creating great problems for those who are living under it. Simply, it's encouraging them to be less than efficient in the marketplace. It encourages them to make risky loans and loans which no one in our business could possibly make, since we are subject to credit ratings by Standard & Poors, Fitch's, and other credit rating agencies.

One of the concerns—let me just add to this—for instance, that was made by Treasury, is that if we create a consumer bank, Citibank might spin off its commercial operations and just become a consumer bank. Well, that really denies reality, because Citibank could no more spin off its commercial operation into a separate subsidiary and receive any kind of credit rating with which it could live and do business in the competitive marketplace than I could fly to the moon.

The CHAIRMAN. You don't think their Mexican and Brazilian loans would qualify?

Mr. EVANS. Well, we think they would probably be what we call classified and would have to be reserved to a very great extent.

But seriously, that likelihood is not possible nor is it for another reason—banks enjoy, let's say Citibank enjoys a leverage of about 20 to 25 to 1. It should be about 20 to 1. Most finance companies are leveraged at about 5 to 8 to 1. They would have to shrink their entire business or bring new capital into it under these very adverse risk conditions. It would be impossible for them to do so.

The CHAIRMAN. I was interested in your comment that their cost is more, and the example you used is GMAC. I constantly hear the argument from the other side, from securities firms, that banks have a great funding cost advantage.

INSURANCE PROBLEM

Mr. EVANS. I think it's more then just access to capital markets, because the policy of our Federal Government is to insure wealth and not just the monetary system. We've gone from insuring the transaction accounts, which is the monetary system, with $2,500 of Federal deposit insurance to $100,000 today, which is all out of line or reason for the actual underlying purpose of the original insurance. I think perhaps that is the problem we have. Otherwise, I don't think the rate differentials are all that great.

The CHAIRMAN. Insurance agents and others have expressed concerns about lenders, especially banks, being able to implicitly or indirectly coerce borrowers to purchase additional services and products, specifically insurance. What is your experience with finance companies and others making these kind of loans? Have they sold insurance or other products as a large percentage of their borrowing customers, or a small percentage, or what?

Mr. EVANS. Most insurance that's sold in straight loan transactions is credit-related insurance. We don't really get into the business of selling casualty insurance policies other than on perhaps security. So it hasn't been a major problem.

There are problems of coercion from time to time which we all have to deal with, but as far as cross-selling or tying, most of the concerns of insurance agents—and I know you have been in the business—when they really pin them down—have to do with very large commercial transactions. They have no interest basically in consumer insurance transactions or consumer-related insurance.

The CHAIRMAN. Tomorrow we will continue the hearings with the State commissioners of banking, savings and loan, insurance, credit unions, and securities, and also have some consumer group witnesses tomorrow.

The hearing is adjourned.

[Whereupon, at 11:30 a.m., the hearing was adjourned.]

[Additional material supplied for the record follows:]

NATIONAL COMMERCIAL FINANCE ASSOCIATION

NCFA

ONE PENN PLAZA, NEW YORK, N.Y. 10001 (212) 594-3490

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A. Bruce Schimberg
Sidley & Austin

Executive Director
and Secretary
Leonard Machlis

March 8, 1984

The Honorable Jake Garn
Chairman
Senate Committee on Banking Housing and Urban Affairs
United States Senate
534 Dirksen Building
Washington, D.C. 20510

Dear Chairman Garn:

The National Commercial Finance Association (NCFA), the national trade association representing the asset-based financial services industry would like to restate its appreciation for your efforts to enact a federal preemption of state usury ceilings as enunciated in Title VII of S.2181 the "Financial Services Competitive Equity Act". Your ongoing support for this issue has maintained its viability as a topic to be dealt with by Congress.

Although we have voiced our concern and expressed our interest in this topic on numerous occassions in the past, we would like to take this opportunity while hearings are being held on S.2181 to reiterate the need for a federal usury preemption.

Many of the comments provided herein were made in 1983 when hearings were being held on S.730 the "Credit Deregulation and Availability Act of 1983". The issues raised at that time are no less valid now and we would like to restate them and request that they be made a part of the current hearing record.

The membership of the NCFA is made up of the asset-based lending arms of domestic and foreign commercial banks, independent finance companies, factoring organizations and financing subsidiaries of major industrial corporations whose chief business is to offer secured credit and factoring services to manufacturers, wholesalers, and retailers. While these borrowers are both large and small, the bulk of them are properly characterized as small and medium sized business. Our industry is not engaged in consumer lending. Our membership runs the gamut in size from the asset-based financing divisions of large banks such as Security Pacific in California and First National Bank of Chicago, in Illinois to small privately held companies such as Puritan Finance Corporation in Illinois and Summa Capital Corporation in New York. Attached for your information is a list of the more than 200 entities that comprise the membership of the NCFA.

As a national association we have the particular ability to see how the myriad of rates imposed across the country negatively impact on the availability of credit for those who need it most. We would like to emphasize that we are addressing only the need for a business exemption from state usury ceilings.

In spite of relatively stable interest rates currently, the volatility which was experienced not too long ago as well as the constant predictions of impending increases clearly indicates the need to address this issue. The potential for wide swings was illustrated during a seven month period in 1980 when the prime rate varied ten points. It is important to note that the rates charged by commercial lenders are closely tied to prime and are most responsive to market changes both up and downward.

On a substantive level, however, we wish to address the problems caused by the inequality of competitive positions among the states resulting from our current interest rate system, and to provide you with some basic information on the average client of a member of the NCFA and the part our members play in keeping these clients a functioning part of the economy.

The asset-based financial services industry provides funds to companies with annual sales ranging from as little as $250,000 to those with volume in excess of $100 million. The wide range in size of firms we finance clearly deomonstrates the versatility of this financing technique. Furthermore, asset-based loans may be extended in amounts ranging from $50,000 to $50 million.

There is, frequently, no other ready source of funds for these companies who utilize the working capital lines of credit to expand their business. They frequently do not have access to traditional bank loans or the capital market and, therefore, rely virtually exclusively on asset-based lenders.

Volume of loans extended to business by the asset-based lending industry during 1980 exceed 106 billion dollars. A job census survey conducted in 1983 revealed that our industry provides over 800,000 jobs nationwide.

Ready capital is the basic requirement for this business growth, and small and medium size businesses, which can neither generate capital internally or borrow externally are the most severely hurt by a shortage of capital. The restrictive interest rate ceilings which exist in a number of states act to prevent creditors from making needed funds available.

This particularly affects small corporate borrowers who do not have the ability to shop for credit on a nationwide basis. Indeed many states have different ceilings for business loans in smaller or larger categories. Generally in these situations the more restrictive ceiling is placed on smaller amounts. The effect of this is to place smaller borrowers in a tighter credit situation than larger borrowers who have greater leverage. In New York State for example, the Superintendent of Banks report to the legislature in 1981, pointed out that the exemption from the 25% criminal usury ceiling for loans of $2,500,000 or more is of no help at all to small companies whose borrowings do not exceed $2,500,000. In fact, the report specifically mentioned the clients of asset-based commercial lenders as among those borrowers who frequently fall outside the exemption because of the amounts financed.

Coupling this with the fact that during the recent period when the prime reached 21%, many of our smaller members were effectively stopped from doing business, results in a shortage of funds which has nothing less than a choking effect on new enterprise.

At this time when the economy is beginning to show signs of strength it is particularly important to encourage the growth of business.

A Federal usury preemption would permit the competitive forces of the marketplace to freely control the costs of borrowing funds for business purposes and would prevent a situation such as the one recently experienced where the prime rate came so close to the usury ceiling that borrowers, particularly small and medium size firms who have the most difficulty finding capital were effectively unable to obtain funds.

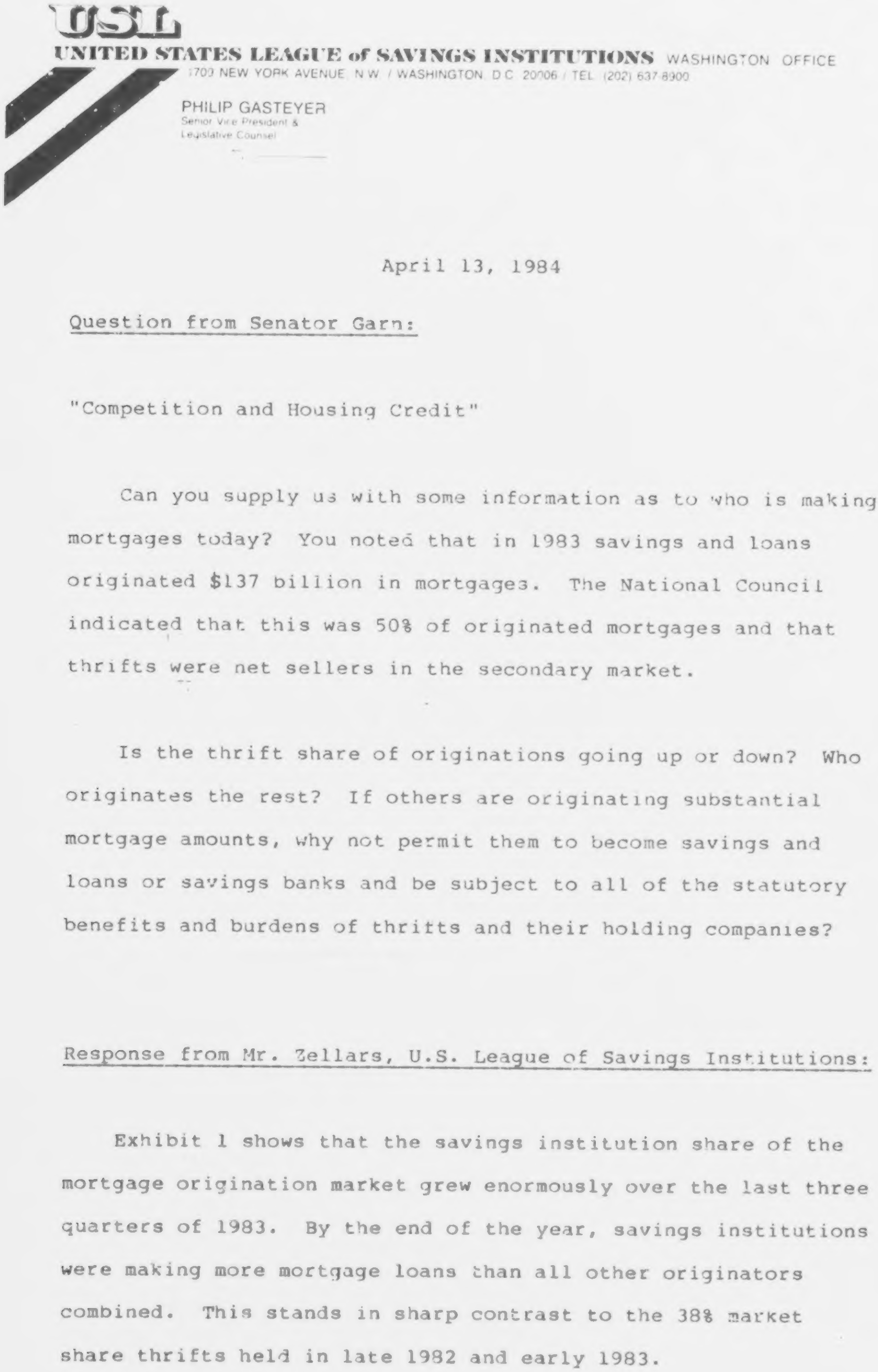
Thank you again for your attention to this issue.

Sincerely yours,

Leonard Machlis
Executive Director

LM/el

[Response to written questions of Senator Garn and Senator Mattingly follow:]



USL
UNITED STATES LEAGUE of SAVINGS INSTITUTIONS WASHINGTON OFFICE
1700 NEW YORK AVENUE, N.W. / WASHINGTON, D.C. 20006 / TEL. (202) 637-8900

PHILIP GASTEYER
Senior Vice President &
Legislative Counsel

April 13, 1984

Question from Senator Garn:

"Competition and Housing Credit"

Can you supply us with some information as to who is making mortgages today? You noted that in 1983 savings and loans originated $137 billion in mortgages. The National Council indicated that this was 50% of originated mortgages and that thrifts were net sellers in the secondary market.

Is the thrift share of originations going up or down? Who originates the rest? If others are originating substantial mortgage amounts, why not permit them to become savings and loans or savings banks and be subject to all of the statutory benefits and burdens of thrifts and their holding companies?

Response from Mr. Zellars, U.S. League of Savings Institutions:

Exhibit 1 shows that the savings institution share of the mortgage origination market grew enormously over the last three quarters of 1983. By the end of the year, savings institutions were making more mortgage loans than all other originators combined. This stands in sharp contrast to the 38% market share thrifts held in late 1982 and early 1983.

The other significant mortgage originators are commercial banks and mortgage bankers. There is no reason that such firms could not apply to become savings institutions if they are willing to meet all the requirements placed on thrifts. While some small commercial banks may become thrifts, most mortgage bankers and their holding company parents are unlikely to do so.

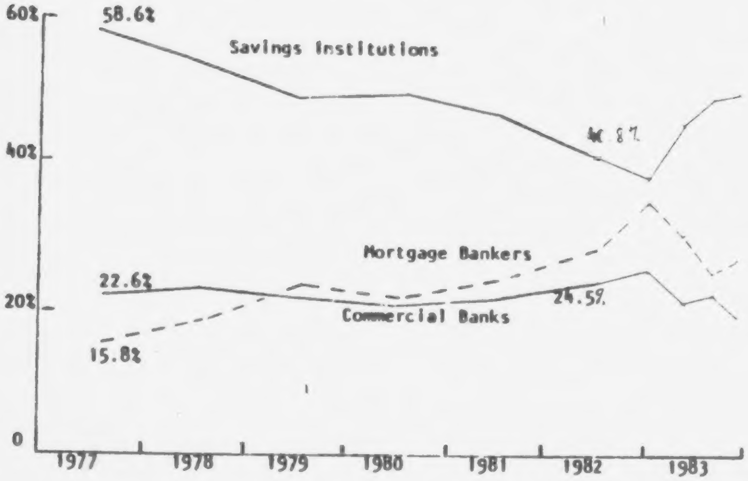
Exhibit 2 illustrates that with the exception of 1982, which can be explained by various extraordinary factors such as purchase accounting and loan swaps for FHLMC and FNMA securities to back consumer repos, savings institutions sell very few mortgage loans in net. For example, in 1983 thrifts sold only $8.1 billion net out of the $137 billion they originated. Further, most of these net sales took place in the first-half of 1983. Savings institutions were net purchasers of mortgage loans during the first two months of 1984.

In addition, net mortgage loan sales figures do not give thrifts credit for their active purchase of mortgage-backed securities. In 1983, thrifts added more than $20 billion of such securities to their portfolios. This addition to the thrift mortgage portfolio was more than twice the net loan sales figures of $8.1 billion and, thus, more than offset the sales impact on the industry's mortgage portfolio assets.

Mortgage bankers -- whether independent or holding company subsidiaries -- do not hold the loans they originate. In 1983, these firms sold more than $50 billion in mortgage loans. Thus, they do not provide the vital mortgage portfolio lending support function to housing that thrifts have always provided.

In order to become thrifts, these firms and their holding companies should be required to become mortgage portfolio lenders. This is the key reason that the thrift lender test must be based on a percentage of assets.

EXHIBIT 1: SAVINGS INSTITUTIONS HAVE RETURNED TO THE MORTGAGE MARKET JUST AS THEY DID FOLLOWING PAST RECESSIONS

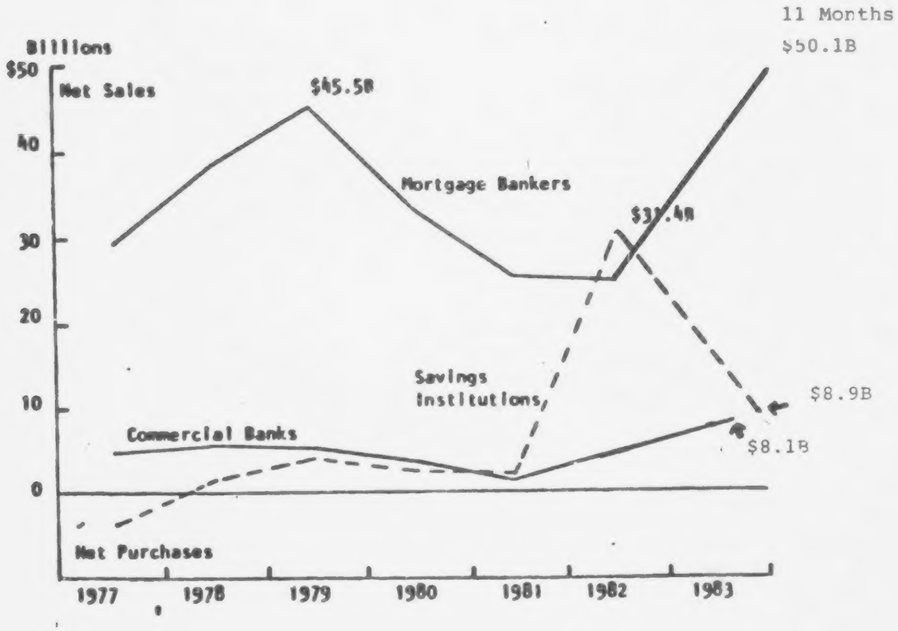


Share of Home Mortgage Loans Made

	1982	1983			
	4th Qtr.	1st Qtr.	2nd Qtr.	3rd Qtr.	Oct.-Nov.
Commercial Banks	27.2%	25.1%	21.4%	22.3%	19.4%
Savings Institutions	37.9%	38.0%	46.5%	50.1%	50.9%
Mortgage Banks	30.7%	34.1%	29.9	25.3%	26.8%

Source: H.U.D.

EXHIBIT 2: SAVINGS INSTITUTIONS ARE ONCE AGAIN HOLDING THE OVERWHELMING MAJORITY OF LOANS THEY MAKE AS THEY HAVE FOLLOWING PAST RECESSIONS



Source: H.U.D.

Question from Senator Garn:

"Mortgage Test"

The National Council contended in its testimony to the Committee that "the mortgage asset test fails to recognize that mortgage finance has become an integral part of the national capital market".

What is your response to this?

Response from Mr. Zellars, U.S. League of Savings Institutions:

In fact, the qualified thrift lender test does explicitly recognize that mortgage securities are traded in this nation's capital markets. It does this by including mortgage-backed securities and net mortgage loans purchased as qualifying assets for the thrift asset test.

Question from Senator Garn:

You both suggest that any qualified thrift lender test allow for the fact that many thrifts are originating and selling mortgages into the secondary market.

1. Doesn't this tend to promote thrifts as mortgage bankers?

2. If this is the case, wouldn't it be acceptable to permit banks, mortgage bankers or others meeting such a test to have access to the Home Loan Banks?

Response from Mr. Zellars, U.S. League of Savings Institutions:

Our suggestion that a housing-related qualified thrift lender test should give some recognition to mortgage origination and servicing activity was not intended to "promote thrifts as mortgage bankers". It was merely recognition that savings institutions -- pursuing sound business strategies at various points in the interest-rate cycles -- also contribute to the public policy of assuring credit for homebuyers through mortgage origination and sale.

Most savings institutions will remain essentially portfolio investors in mortgages over the long-haul. But some recognition for mortgage origination and servicing activity is needed to accommodate the operational flexibility for institution management.

We do not see how such recognition in the qualified thrift lender test particularly encourages, or discourages, mortgage banking activity. Frankly, we doubt that a corporation devoted solely to mortgage banking would find in advantageous to continue to comply with the elaborate regulation and net worth requirements of a depository, particularly now that savings rate deregulation has been completed and the vast majority of funds are acquired at market rates.

With respect to commercial bank access to the FHLBank system, the League on page 18 of its testimony on February 28, 1984 indicated its support for commercial bank FHLBank membership, provided the bank passed an appropriate asset-composition test.

While we have not formulated a final position on mortgage banker membership, we must seriously question the appropriateness of allowing non-depository institutions to become FHLBank members and shareholders. Since 1932 the FHLBank System has served several functions in addition to sustaining mortgage lending. The System was created as a "central banking system" or a liquidity source for the savings institution industry; i.e., it functions as a source of funds for institutions under deposit-withdrawal pressure. While sustaining mortgage availability is another objective, we are apprehensive that admitting large numbers of non-depositories could distort and impair the ability of the System to carry out the important and fundamental liquidity function for its basic insured savings institution membership.

From our perspective, we consider expanded Federal Home Loan Bank System membership a subtopic of the general issue of how to separate the savings institution and commercial banking industries. We feel that the housing-related asset composition test offers a useful and functional approach. Since mortgage banking firms are not chartered by the federal government, do not act as stewards for the public's deposits, or comply with the detailed supervision and other attributes of regulated depositories, they do not enter into the fundamental question of the appropriate statutory framework for the various types of depository institutions. Therefore, membership in a credit facility designed as a support mechanism for depositories should not be a consideration for mortgage banking firms.

Question from Senator Mattingly:

Mr. Zellars, your statement asks us to support an amendment to the Secondary Mortgage Market Enhancement Act -- which the Senate has passed already -- so that S&Ls can set up a mortgage securities subsidiary and fully participate in developing these new mortgage-backed securities or collateralized mortgage obligations?

Why can't we add your request to the omnibus bills we are looking at today rather than amend the Secondary Market Bill?

Response from Mr. Zellars, U.S. League of Savings Institutions:

The Committee, of course, is the best judge of the appropriate legislative vehicle for the authority we seek to establish special-purpose mortgage securities subsidiaries which could engage in the business of issuing, sponsoring, servicing, holding, underwriting, distributing or dealing-in securities backed by conventional home loans.

This subsidiary authority is necessary because there is nothing comparable under the present statutes governing savings institutions which would permit our institutions to contribute mortgage loans to an intermediary trustee -- an essential part of the mortgage securitization mechanism. (The closest existing authority is our service corporation investment power, but that is tightly limited to contributing, or investing, no more than three percent of assets.) Thus, today, we are handicapped compared with other mortgage lending entities in our ability to take part in the development of securities backed by conventional home loans.

Thus, if the Secondary Mortgage Market Enhancement Act, S. 2040, is considered further in this 98th Congress, the U.S. League feels it is essential that the mortgage securities subsidiary language is included -- as a means of "catching up" with the flexibility other competitors in the mortgage marketplace already possess, as well as contributing to the future development of securities products which can tap new sources for mortgage credit.

Authority for savings institutions to underwrite and deal-in mortgage-backed securities also appears in S. 2181.

However, the authority, as introduced, is illusory since it is only provided for affiliates of savings and loan holding companies -- excluding, by definition, the 95 percent of our industry which is mutual in form or stock companies not part of a holding company. Furthermore, S. 2181 would not correct the fundamental defect in our laws -- which, as described above, is the inability to package and issue securities backed by conventional mortgages. S. 2134, of course, only empowers bank holding company affiliates to underwrite and deal-in mortgage-backed securities, making no provision whatsoever for savings institutions or their holding companies.

If our national housing policy is to rely increasingly on securities investors to provide the credit for homeownership, basic fairness requires that savings institutions should have the authority needed to participate fully in the process. This concept was particularly well stated, we thought, in testimony delivered March 14 to a House Commerce Subcommittee by Mr. Lewis Ranieri, Managing Director, Salomon Brothers, Inc.: "The industry representing the nation's largest mortgage origination and investment capability should have the same opportunity that every other type of mortgage originator enjoys to set up and capitalize separate 'securities issuing' subsidiaries."

In sum, we defer to your judgment on the appropriate legislative pathway -- but insist upon the opportunity for all savings institutions, mutual and stock, as well as those part of holding companies, to participate with other mortgage lending entities in securitization developments through new authority for a special-purpose mortgage securities subsidiary.

Question from Senator Mattingly:

Mr. Zellars, your statement discusses at length the 60% housing lender test found for savings institutions in S. 2181. It says very little about the optional, not-more-than-25% commercial lending test. Do we need both tests to distinguish thrift institutions from banks?

Response from Mr. Zellars, U.S. League of Savings Institutions:

It is the recommendation of the U.S. League that the Committee adopt the 60% housing-related test for a qualified thrift lender as the sole dividing-line between the statutory pattern for specialized thrift institutions and commercial banking. Such a standard provides adequate latitude for non-housing investment to strengthen depository institutions committed to the public policy goals of assuring homeownereship opportunities. In conformity with the premable to the landmark Garn-St Germain Act of 1982.

As detailed at greater length in our full written statement the 60% housing-lender test also parallels to some extent the standard found in the Internal Revenue Code which defines "domestic building and loan associations" and the test for unitary savings and loan holding company operations adopted in Garn-St Germain.

Traditional savings banks which desire to retain their residential housing orientation should be given a reasonable period in which to conform to the 60% standards.

By contrast, we cannot endorse the optional, not-more-than-25% commercial (including commercial real estate) investment test. That standard is both too expansive and too restrictive. It bears no recognizable relationship to the traditional home-lending justification for separate regulatory, credit backstop and federal account-insurance systems which uniquely characterize thrift institutions in the financial community. At the same time, by limiting commercial real estat, it is more restrictive than the 40% maximum authority granted just two years ago for federal thrifts as part of the Garn-St Germain law.

In our view, it is far better to define "what you are" than "what you are not" in establishing public policy for the future of the specialized thrift industry.

National Council of Savings Institutions
M. Todd Cooke
Chairman

April 16, 1984

The Honorable Jake Garn
Chairman
Committee on Banking, Housing
and Urban Affairs
United States Senate
Washington, D. C. 20510

Dear Mr. Chairman:

On behalf of the National Council, enclosed are responses to the questions you raised in connection with our testimony before your Committee on February 28, 1984.

We appreciate the opportunity to submit the enclosed in order that they may be inserted into the hearing record of the legislation.

Sincerely yours,

M. Todd Cooke

M. Todd Cooke
Chairman

Enclosure

Responses of Mr. M. Todd Cooke, Chairman
National Council of Savings Institutions

April 16, 1984

1. Small Company Exemption

Q. You propose a creative solution for the problem of mutuals not having holding companies. Would you support a straightforward exemption from the holding company requirement for small banks, mutuals, and stock thrifts with the upper limit being $100 million in assets, for example?

A. The concept of an exemption for small institutions from the holding company requirement would appear to make a good deal of sense. However, it is important to note that a single size specification would not be appropriate for all types of financial institutions. A $100 million exemption for commercial banks might very well be appropriate, but for savings and loans and savings banks which are of a much larger size, on average, than commercial banks, the $100 million exemption would provide little by way of actual relief.

For example, as compared with the average size of $140 million for a commercial bank, the average size of a savings and loan association is $250 million, and the average size of a savings bank is $490 million. There is also the fact that the institutions most likely to use the new securities and other powers contemplated by S. 2181 and S. 2134 would tend to be the larger sized institutions. For these reasons we believe that any exemption based on the size of an institution should be flexibile enough to take into account industry variations.

2. Mortgage vs. Commercial Lending Test

Q. You argue against a mortgage portfolio test, and for a commercial lending test. Although the test can end up with different results, on the same institutions, basically they are measuring the same thing from opposite ends: the institutions' commitment to housing vs. commercial lending. There will be differences only in the slim margin that falls between the two activities. Why then is the mortgage portfolio test so undesirable for you, but the commercial lending test is not?

A. The basic problem with the mortgage test is that it is an attempt to respecialize the thrift industry into mortgage financing. As such, it represents a marked departure from current law and is contrary to the recommendations of every major study in the field, including the 1982 Report of the President's Commission on Housing. Going back as far as the 1971 Hunt Commission, industry, government and private sector experts have uniformly agreed that the best way to encourage mortgage lending activity is to despecialize thrift institutions and thereby create a healthy, more diversified industry.

The National Council opposes any type of asset test since it would necessarily result in placing limitations on portfolio management by thrift institutions. Interest rate ceilings on the liabilities of thrifts and other depository institutions have been largely phased out and will soon be eliminated altogether. We believe that limitations on one side of an institution's balance sheet makes no economic sense whatsoever.

However, if for public policy reasons the Congress decides that some asset limitations are in order, then we believe that the commercial loan test is eminently preferable. To begin with, an asset test similar to that which is found in current law for purposes of determining which institutions are covered by the Bank Holding Company Act (BHCA) would necessarily focus on the extent of commercial lending now authorized for thrift institutions under federal or state law -- generally 10 percent of assets. The mortgage test which is being discussed in the context of the pending federal legislation or the Report of the Vice President's Task Group on Regulation of Financial Services, is geared toward a minimum 60 percent of assets. We naturally prefer to see the limitations on as small a proportion of our portfolio as possible.

Secondly and most importantly, the commercial loan vs. mortgage test must be distinguished on the basis of what question is being answered. If the question is which thrift institutions should be regulated on the same terms as commercial banks. then the only logical test is commercial lending which is, after all, the hallmark of commercial banking. Commercial lending is also the well established standard under current law for determining which institutions are covered by the BHCA. If, on the other hand, the question is which institutions should be entitled to membership in the Federal Home Loan Bank Board with the availability of federal assisted borrowing, then some type of mortgage test may make sense. Our point is that any exclusive test -- whether it be mortgages or commercial lending -- will be flawed if it tries to answer two very different questions with just one formula.

Finally, we would caution that any mortgage test, even one limited to eligibility for FHLBB advances, be enacted in such a manner as to take cognizance of institutional, regional, and other variations which may arise in a given market at any given time. Precise numerical standards should be avoided in any statutory language and sufficient flexibility vested in the regulatory agencies to develop a mortgage test that accommodates the vast differences which exist in financial markets today.

COMPETITIVE EQUITY IN THE FINANCIAL SERVICES INDUSTRY

PART II

WEDNESDAY, FEBRUARY 29, 1984

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, D.C.

The committee met at 9:30 a.m., in room SD-538, Dirksen Senate Office Building, Senator Jake Garn (chairman of the committee) presiding.

Present: Senators Garn, Mattingly, Hecht, and Dixon.

OPENING REMARKS OF CHAIRMAN GARN

The CHAIRMAN. The Banking Committee will come to order.

We continue our hearings today on S. 2181 and S. 2134, the Financial Institutions Deregulation legislation. We have a distinguished panel before us first this morning, Mr. William C. Harris, president elect, Conference of State Bank Supervisors; Illinois State Commissioner of Banking and Trust Companies; Hunter O. Wagner, Jr., vice president, Board of Directors, National Association of State Savings and Loan Supervisors; Louisiana State Commissioner of Financial Institutions; Bruce W. Foudree, chairman, Integrated Financial Services Task Force, National Association of Insurance Commissioners; Iowa State Insurance Commissioner; Michael Unger, president, North American Securities Administrators Association; director, Massachusetts Securities Division; accompanied by Franklin Tom, chairman, Financial Institutions Committee, North American Securities Administrators Association; California State Commissioner of Corporations; and Charles W. Burge, president, National Association of State Credit Union Supervisors; Georgia State Deputy Commissioner for Thrift Institutions.

Before we start, gentlemen, Senator Dixon would like to introduce Mr. Harris and Senator Mattingly would like to introduce Mr. Burge.

STATEMENT OF SENATOR DIXON

Senator DIXON. Mr. Chairman, I thank you for the privilege of introducing to the committee an old and dear friend of three decades who began with me in public service back in Illinois in the Illinois House in the 1950's. Bill Harris and I served in the Illinois House together and in the Illinois Senate together. I was on the

Democratic leadership team in both houses and he was on the Republican leadership team in both houses.

We were candidates against one another for the office of Illinois Secretary of State in 1976. We have been dear friends for three decades. He's an outstanding public man who knows a great deal about the banking question. He's been a distinguished commissioner of banking and trust companies in our State under our Republican Governor Jim Thompson. I think he's an exceptional person. Should that governorship ever change to a Democrat, I would continue to support him for commissioner of banking and trust companies. He's just an outstanding public man. It's my privilege to present to Senators Hecht and Mattingly and the chairman, Senator Garn, a dear friend of an adult lifetime, William Harris, the Illinois State Commissioner of Banking and Trust Companies.

The **CHAIRMAN**. Senator Mattingly.

STATEMENT OF SENATOR MATTINGLY

Senator **MATTINGLY**. Mr. Chairman, I would like to welcome to the Senate Banking Committee today Mr. Charles Burge, who is deputy commissioner for thrift institutions for the State of Georgia. Today he's representing the National Association of State Credit Union Supervisors and was recently elected president of the NASCUS at its 18th annual meeting in Jackson Hole, Wyo.

I welcome you to the Senate Banking Committee this morning, Mr. Burge. The chairman has asked me frequently why we have so many people from Georgia come before our Banking Committee to testify. My answer is that we have a concentration of people in our state that have great ideas and high IQ's. We're very modest also.

The **CHAIRMAN**. Does the Senator from Georgia include himself in that description?

Senator **MATTINGLY**. I'll leave that up to the voters of Georgia.

Senator **HECHT**. Mr. Chairman, may I ask a question of Senator Dixon? Who won that race? I was wondering about the answer.

Mr. **HARRIS**. Mr. Chairman, he beat the hell out of me. [Laughter.]

The **CHAIRMAN**. Mr. Harris, would you like to begin?

STATEMENT OF WILLIAM C. HARRIS, PRESIDENT ELECT, CONFERENCE OF STATE BANK SUPERVISORS; ILLINOIS STATE COMMISSIONER OF BANKING AND TRUST COMPANIES

Mr. **HARRIS**. Thank you, Mr. Chairman, and I must acknowledge first I'm overwhelmed and thrilled that my former Illinois General Assembly colleague would be so gracious here in this auspicious and somewhat awesome setting.

Mr. Chairman and members of the committee, I'm William C. Harris, commissioner of banks and trust companies for the State of Illinois and president-elect of the Conference of State Bank Supervisors, on whose behalf I am testifying today.

We're pleased and grateful to have this opportunity to testify before this honorable committee and to share with you our concerns.

When CSBS President Sid Bailey appeared before this committee in May 1983, his message was one of pride; pride that States have been taking the initiative to make a wider range of banking services available to the American public, not only intrastate but also interstate, and thus to improve the competitive position of traditional depository institutions vis-a-vis the nonregulated and less regulated financial intermediaries. I want to reaffirm those thoughts of President Bailey here in my presentation today. States have recognized and have accepted, to an ever increasing degree, not only their authority but also their responsibility under the existing scheme of laws pertaining to banks, to bank holding companies, and other financial institutions and to business corporations in general.

The problems faced today seem to be at the extremities, not at the heart of the dual banking system. It is the stretching at the edges of the fabric of our system and the legal loopholes that, in our judgment, need repair. We may need a tuneup and a set of plugs, but not a new automobile.

PRIORITIES OF CSBS

I would like to shift from my prepared testimony now because we have filed it with the committee and know that your staffs will analyze my detailed prepared text. Preferably, in order to conserve time, I'd just like to visit with you about our priorities and then make myself available for any questions that might occur to you.

CSBS favors generally, on an expedited basis, enactment of rather comprehensive legislation in this session of the Congress. We believe there is sufficient need out there for you to act and in sharing with you my observations I'll try to convince you that there is a need for action by the Congress now.

The CHAIRMAN. I am already convinced, but we're happy to listen.

Mr. HARRIS. OK. Thank you, Mr. Chairman.

Our No. 1 priority would be to have congressional action closing the nonbank bank loophole. That would be our No. 1 specific concern.

No. 2, we would urgently suggest that since we have deregulated the liability side of the banks' balance sheet, there should be deregulation, to a reasonable extent, consistent with safety and soundness, on the asset side. We would not presume to say it ought to be, this, this, and this. We think that those general policy considerations ought to come from this honorable body and your colleagues across the rotunda, but that would be No. 1 for us—additional asset powers.

No 3, we are extremely interested as a conference representative of State banking in all the States and the three territories that the principle of McFadden and Douglas be applied to cross-industry acquired thrifts as such activity continues, which seems to be coalescing into public policy.

RECIPROCITY FROM FOREIGN NATIONS

No. 4, we favor explicit statutory recognition of the rights of States to require reciprocity from foreign nations which we think already is provided in the International Banking Act of 1978. If you care to explore that, Illinois, the State that I represent, is somewhat unique among the States in that we feel very strongly about that issue. Of course, I'm speaking today from the conference's standpoint.

The CHAIRMAN. Mr. Harris, I would just interrupt to say that if the State bank supervisors are not aware of it, I do have a separate bill that was introduced in November that I do intend to pursue. It's totally separate from this on the issue of reciprocity and specifically made a trip to Australia in December to tell them about it because Australia is one of the worst problems in that area. They have some abilities in this country that our own domestic banks do not, like operating across State lines, and yet they allow no foreign banks to operate in their country.

They allow some minority ownership of what are known as merchant banks which are not retail banks, and so I do have a bill in on that very specific issue that you are talking about. If countries don't want to treat our banks the same, whatever it is, I think we ought to move for reciprocity and say, fine, if you don't want to let our banks in your country, then we don't let yours in ours.

Mr. HARRIS. I couldn't agree more. I am compelled to get excited by your interruption. You can interrupt me like that any time.

The CHAIRMAN. When we passed the International Banking Act in 1978, I think that was what was intended, and my bill is essentially an amendment to the International Banking Act of 1978 to make certain that what we intended then is taking place. It obviously was not drafted carefully enough to accomplish what we wanted to.

Mr. HARRIS. Well, that is precisely the point of the litigation that Illinois has engaged in on that specific issue. I think it's appropriate to refer back to the question of nonbank banks. It does seem to me and particularly in the light of *Beehive*, that decision which I know you are familiar with, Mr. Chairman, that Congress does need to make certain that definitions and past congressional enacted law is understood and is perhaps more understandable. Such clarification is needed so that we don't have to have that kind of regulatory and judicial interpretation, but really understand what is congressional intent. And I just encourage you to square away some of the innovative judgments by some regulators that have occurred.

The CHAIRMAN. Well, Senator Hecht was with me and he will verify that we gave Australia and some other countries the message. They understood it loud and clear, I believe.

Mr. HARRIS. Super. Well, I couldn't be more pleased.

I was dealing with point No. 4 of our priorities that we favor action on.

Additionally, within that request for explicit statutory recognition of the rights of States to deal with the question of reciprocity, vis-a-vis foreign banking institutions, we also are extremely interested in the rights of States to place conditions on entry with respect to permission to operate on an interstate basis under the provisions of the Douglas amendment domestically.

No. 5, we favor provisions, as you do provide for in the bills before this committee, for a simplified process of the formation of bank holding companies. We would take that a step further and say that as you add powers on the asset side of the bank balance sheet that we favor authorization for bank subs to have added powers, not only through the means of organization into a holding company, but also for the smaller banks themselves, such as the independent or the community bank, with which class of banks the conference deals in great numbers.

I know the members of the committee and your staffs are familiar, that, of the some 15,000 total banks chartered in the United States, well over 9,000 of them exist within the State-chartered system.

No. 6, we would favor the establishment of statutory safeguards dealing with the cross-industry acquisition of thrifts by banks—and I would speak personally for a moment now as an Illinois regulator. I'm one who believes that the arrows ought to point both ways, that cross-industry ought to work not only as to banks acquiring thrifts on an arm's length negotiated basis in the absence of emergency circumstances but as to the acquisition of banks by thrifts, as well. If they want to engage in such acquisitions, the arrows ought to work in an operative way from the point of view of either industry. I speak in that regard as an individual regulator and not as a representative of the conference.

No. 7, we favor the requirement or authorization of the payment of interest on reserves required by the establishment of new accounts.

Now that's our list of priorities. We would like to share with you some things about which we speak in opposition. I'm trying to lower my voice a little bit because I like people who are for things rather than against things. We do have some concerns about some elements within the legislation before you.

OPPOSE BROAD PREEMPTION BY FEDERAL LAW OF STATES' ABILITY TO DEAL WITH PROBLEMS

In principle, we oppose a broad preemption by Federal law of States' abilities to deal with problems and policy within the several States. We just think that the dual banking system has worked to a remarkable degree of satisfaction for the users of banking services. No industrial country of the world has anything to match the competitiveness and the diversity of the dual system and out of that system of banking services comes safety; safety that obtains here in this remarkable American system of having 15,000 places from which you can seek commercial credit and have depository services almost 100 percent isolated from risks. Man, that's awful good. That's great!

So we would urge you to be wary of any broad preemption from the Federal level imposed upon States' ability to react to specific problems within the specific borders of States respecting their State-chartered banking system.

Let me just affirm that we are concerned about the question of for-export-only local statutes—I think you all understand what I'm referring to about State initiatives that are for export only. If I'm asked to be specific, I will be, but we are deeply concerned about that and in your activity to solve such a problem we would urge caution and care not to interfere to too great an extent. Again, this may be the same as my first caution about things that we're negatively concerned about, things that you should be extremely careful about. We would favor the chairman's rifle shot dealing with that question in your bill rather than the ranking minority member's bill that deals, we think, too broadly with respect to repairing that problem, although which we do recognize it as a serious problem.

We oppose the creation of consumer banks whose existence would seem to ratify and leave in place the exceptions that have arisen through the nonbank bank loophole, both with respect to the definitions and the powers that they have.

Last, a matter about which we have some negative concerns, I think I've touched on it already, would be the limitation of added banking powers only to bank holding companies' subs. We feel that for a great number of banks to require them to go through the drill of forming a bank holding company and be held thereby in order to avail themselves of added asset powers would be burdensome and unjustified, especially with respect to those excellent and well-operated—and they mostly are—independent and community banks. I speak in nonproper noun terms when I refer to independent and community banks.

Now, in closing, let me just make this comment, that it is terribly important to preserve the distinction of deposits and freedom-from-risk deposit accounts that the consumers of our country have come to respect and trust. The action by the Congress a good many years ago to separate banking as institutions to safeguard people's funds and to have them readily available on demand is terribly important and should be preserved. Some separation needs to go on between that unique provision of deposit security that exists in this country and investment accounts involving varying degrees and elements of risk.

We urge on you that you continue to observe that very special distinction as you move toward the coalescence of comprehensive legislation dealing with banking and financial services. We believe that Congress should properly assert itself and deal with some of the regulatory innovations that have gone beyond what we think you have written into the law, which apparently needs to have some new definitional attention by you, in whom the ultimate representation of the people abides.

We certainly thank you and applaud you for the attention that you here in the Senate are giving to that consideration for the benefit of the public.

[The complete statement follows:]

STATEMENT OF COMMISSIONER WILLIAM C. HARRIS

ON BEHALF OF

THE CONFERENCE OF STATE BANK SUPERVISORS

Mr. Chairman, members of the Committee, I am William C. Harris, Commissioner of Banking and Trust Companies for the State of Illinois and President-Elect of the Conference of State Bank Supervisors, on whose behalf I am testifying today.

The Conference of State Bank Supervisors (CSBS) is the professional organization of state officials who charter, regulate and supervise the approximately 10,500 state-chartered commercial and savings banks of the nation. Created in the early 20th Century as a clearing house for the ideas of the state bank supervisors on common problems, CSBS has evolved into the major champion of our decentralized American banking and bank regulatory structures. In addition, the Conference has become the most significant single source of educational and research services aimed at strengthening individual state banking departments.

We are pleased to have this opportunity to testify before this Committee and address our concerns.

It seems especially appropriate today to commend the members of this Committee for their efforts to look before they leap, so that we do not become wedded to something with which we cannot live.

When CSBS President Sid Bailey appeared before you on May 20. 1983, his message was one of pride: pride that states have been taking the initiative to make a wider range of banking services available to the American public, even across state lines, and to improve the competitive position of traditional depository institutions vis-a-vis the nonregulated financial intermediaries. I want to echo those thoughts. States have realized to an ever increasing degree both their authority and their responsibility under the existing scheme of laws pertaining to banks, to bank holding companies, to other financial institutions and to corporations, generally.

Yet, even as states continue to exercise their authority and to increase their role in bank and bank holding company regulation, we find increasing resistance here in Washington, D.C. Where once we were accused of doing too little, we are now accused of doing too much, particularly with regard to deregulation. Where once we were accused of being "weak sisters" in the scheme of regulation, examination and supervision, we are now faced with a lingering reluctance on the part of some to recognize our proven capability, particularly where this would require a withdrawal of the presence of federal agencies from state-chartered institutions. I am happy to recognize, however, that the FDIC has adopted a policy of decreasing its examination and supervisory presence in non-troubled state-chartered institutions, and that discussions have been initiated with the Federal Reserve to reduce the wasteful overlap of their examination and supervision of state-chartered member banks.

The problems faced today seem to be at the extremities, not the heart of the dual banking system. It is the stretching at the edges of the fabric of our system and the legal loopholes in it that need repair. We need a tune-up and a new set of sparkplugs, not a new engine or a new vehicle.

In an effort to make the issues presented by S. 2181 and S. 2134, and related matters, more manageable, I will address only those in which CSBS has a keen interest by issue, rather than going through the bills title-by-title.

Definition of "Bank"

The number one short-range priority for CSBS remains a Congressional solution to the so-called "non-bank bank" loophole. At this stage of the game it is unnecessary for me to spell out one more time what that loophole is or how it is being used to circumvent existing bank and bank holding company laws. Suffice it to say that no more serious threat exists to the dual banking system and to Congressional policies regarding the separation of banking from other lines of commerce.

The Conference prefers the approach taken by S. 2134. The inclusion of institutions eligible for FDIC insurance and the lack of a long list of institutions excepted from the operation of its provision make S. 2134 a viable, permanent solution to the question of what is a bank for purposes of the Bank Holding Company Act.

We oppose the creation of consumer banks, as embodied in S. 2181, which seem to ratify rather than plug the loophole. The Conference appreciates the efforts of the Chairman to fashion Douglas-type provisions to control interstate operation of consumer banks. However, these provisions would appear to permit interstate expansion into states which have statutory provisions for "similar institutions", including a variety of institutions the powers of which are less sweeping than those of a consumer bank and the intent behind which did not include interstate operation of bank holding companies. The vast majority of the states would prefer to see the non-bank bank loophole permanently closed, with industrial banks and similar institutions made subject to the Bank Holding Company Act provisions relating to banks. Some accommodation for those states in which interstate ownership of industrial banks by bank holding companies is already a fact of life would, of course, be necessary. A grandfathering of existing activities beyond those permissible under the Act on an intrastate basis would be necessary as part of grandfathering existing, state-ratified interstate ownership of industrial banks.

As proposed, consumer banks would be eligible for ownership by commercial entities ineligible to become bank holding companies. The potential for competitive inequities to develop between deposit-gathering, relatively unregulated commercial entities and the heavily regulated traditional depository institutions appears great. This would be particularly true of retailers of goods, which could tie-in consumer financing and depository accounts free of bhc-type regulation.

While we prefer the approach to closing the non-bank bank loophole set forth in S. 2134, inclusion of institutions eligible for FDIC insurance has a "catch-22" which would have to be ironed out. State-insured institutions and those with state-approved private insurance should not be forced by operation of the definition section and the bank subsidiary provisions to convert to FDIC insurance. Yet, this would be the practical effect of S. 2134, since Section 3 of the act requires all bank subsidiaries to be FDIC insured. If institutions eligible for FDIC insurance are to be included in the definition of "bank", Section 3 needs to be amended to allow bank subsidiaries to maintain state insurance or state-approved insurance.

CSBS supports wholeheartedly a meaningful, permanent solution to the "non-bank bank" loophole. Moratorium proposals which seemed appropriate as temporary measures a year ago might now serve to slow action on needed permanent reform.

Perhaps the best long-term solution would be to regulate through a "depository institutions holding company act" all depository institutions with statutory authority to engage in similar activities, as has been done in the State of Maine. Moves toward subjecting unitary S&L holding companies which fail to maintain a sixty percent level of qualifying assets to bank holding company-like restrictions appear to be a positive step in that direction.

New Bank And Bank Holding Company Powers

CSBS recognizes that some expansion of bank and bank holding company roles is necessary to meet market challenges. We have, as a body, adopted a policy which would endorse some expansion of banking powers, following a weighing of public interest considerations.

Our position, as bank regulators, places us somewhere between those who call for complete deregulation and open across-the-board competition--"financial supermarkets", if you will--and those who would halt the flow of progress completely. From early on we favored and actively worked for liability-side deregulation, both because it benefitted the public and because it allowed banks to be competitive in attracting funds, adding thereby to the industry's long-term viability. As the last Congress was the time for liability-side deregulation, so now is the time for some asset-side deregulation. The reasons remain the same: to assure long-term viability of the industry, to give the public the benefits of increased competition, and to facilitate better allocation of financial resources.

However, there are some balances which must be struck. The ability to compete and assure long-term industry viability must be balanced against the potential for risk in each new activity and the public interest in safety and soundness. The avoidance of concentration of economic power in the hands of relatively unregulated business entities must be balanced against the risk of increased concentration of economic power within the banking industry itself. The beneifts of relaxing distinctions between banking and other lines of commerce must be balanced against the potential for erosion of the unique role of banks in our payments system, as intermediaries between organizations and people and as safekeepers of deposits and savings not placed at risk.

The continued viability of banking as a mechanism as well as an industry demands a balanced approach to deregulation. The end result must be a healthy industry able to serve local community, as well as national and international, needs.

The Conference supports some expansion of bank powers. However, we oppose limiting new bank powers to the subsidiaries of bank holding companies only, requiring conversion to the holding company format in order for a bank to benefit from deregulation. We favor allowing banks which are not already a subsidiary of a holding company to operate the new activities out of a separate subsidiary of the bank itself.

Basically there are two arguments put forth in favor of granting new powers to bank holding company subsidiaries only: (1) the increased safety and soundness of the "Chinese Wall" and (2) the regulatory savings and use of available expertise through regulation by function.

The members of the Conference have seen no evidence that the

"Chinese Wall" restrictions contained in the Bank Holding Company Act provide an effective safety and soundness barrier to institutional failure. Rather, they are "fair weather" safeguards which are all too easily ignored when failure of a major holding company subsidiary is imminent. The failure of holding companies, brought about by the failure of non-bank subsidiaries, have not been able to be kept from impacting upon subsidiary banks. To the extent that any value does derive from transaction limitations between bank and non-bank subsidiaries, those same benefits could be derived from extending similar limitations to transactions between a bank and its separate subsidiary and requiring separate capitalization.

The Conference endorses the concept of regulation by function with regard to many proposed new activities, including insurance and securities activities. The expertise of existing agencies should be fully utilized, the potential for duplicative and overlapping regulation and examination should be avoided and the type and level of regulation should be equal for competitors engaging in the same activities. But, again, none of the benefits of regulation by function would be enjoyed less if applied to separate bank subsidiaries, with a discrete set of books and an officer responsible solely for the subsidiary operation and answering to its federal or state regulator.

These considerations are especially true when applied to state and municipal revenue bond underwriting. CSBS has long advocated allowing banks to underwrite these bonds, based primarily upon the benefits which would accrue to state and local governments and to the public at large, with little or no increase in risk to banks.

The case for this minor change in bank powers has been made on the record before this Committee many times; and several times adding municipal revenue bond underwriting authority to existing bank authority to underwrite general obligation bonds has come close to enactment. CSBS cannot understard the logic of now passing it as part of a larger package requiring conversion to the holding company format. State and municipal revenue bond underwriting should be permitted to banks, as is the case with underwriting of general obligation bonds.

The above notwithstanding, CSBS favors streamlining of bank holding company formation, as provided for in both S. 2181 and S. 2134.

Cross-Industry Acquisitions

S. 2181 would permit cross-industry acquisition of thrifts by bank holding companies. CSBS takes no position on whether such cross-industry acquisitions are a desirable step in the evolution of our system of financial institutions. However, we strongly urge that both the possible inequities resulting from cross-industry acquisition and the possible adverse effects identified by the Federal Reserve Board in a series of decisions, beginning with the D.H. Baldwin decision in 1977, be modified.

Toward this end we applaud the Chairman's foresight in subjecting cross-industry acquired S&Ls to the provisions of the Douglas Amendment and the McFadden Act. It is unclear, however, from the language of the bill, whether the Douglas provisions would or would not apply to the first thrift acquisition of a bank holding company. The Conference would oppose cross-industry acquisition on a "first-time-anywhere" basis. The result would be a competitive advantage to the acquiring bank holding company and the destruction of state authority over structure, particularly in certain "target" states.

The decision of the Federal Reserve Board in the recent acquisitions of First Federal Savings and Loan Association of Chicago, Chicago, Illinois (First Federal) and New Biscayne Federal Savings and Loan Association, Miami, Florida (New Biscayne) by Citicorp under the emergency provisions of the Garn-St Germain Act recognized the possible adverse effects of cross-industry, interstate acquisitions. Notwithstanding the facade created by Citicorp that its Person-to-Person, Inc. subsidiary, not Citicorp directly, is the acquiror, the net effect of this acquisition is the same as that of any other cross-industry purchase. Several conditions were imposed by the Fed to mitigate those adverse effects, including many which were not mandated by law, such as the following:

. the thrift must operate with its primary purpose as the provision of residential housing credit.

. no out-of-state remote service units may be established.

. the savings and loan must be operated as a separate, independent profit-oriented corporate entity--not in tandem with any Citicorp subsidiaries.

. financial transactions between Citicorp subsidiaries and the savings and loan are limited.

. the use of the word "bank" in the name of the savings and loan is prohibited.

. charter conversions by the thrift are prohibited.

In addition, Citicorp made three "commitments" in connection with its application:

1. The thrift will maintain at least the same percentage of its assets invested in home state residential mortgages as are invested as of the date of the order.

2. The thrift will use its commercial lending powers under the Home Owners' Loan Act for the benefit of small business in the home state.

3. The thrift will develop community programs specifically tailored to the needs of home state communities served by it.

Also, the Fed has required in each case that Citicorp maintain the capital of the savings and loan at no less than 6% of the institution's liabilities, until at least December 31, 1985.

The Conference opposed unrestricted acquisition of the thrifts by Citicorp. CSBS argued that if the sale could not be denied, then stringent conditions must be placed on operations of the thrift. CSBS approves of the conditions imposed by the Fed.

However, conditions on acquisitions of this type have limited value, since the New York Federal Reserve Bank may relax the conditions for specific transactions and the Fed may revoke them at will. Citicorp has had some success in having conditions on its acquisition of a California S&L relaxed in the past and has asked the Fed to remove some of these conditions at this time.

The Conference believes that the emergency provisions of the Garn-St Germain bill (Title 1) should be amended to require that conditions such as those listed above be placed on all cross-industry interstate acquisitions. We believe that this step is necessary to guarantee these public safeguards and not leave to agency discretion either their imposition or their subsequent relaxation.

Conditions such as the above should also be considered as a part of legislation permitting cross-industry acquisition of non-troubled thrifts. Such conditions, together with the full "McFaddenization" and "Douglasization" of cross-industry acquired S&Ls now in S. 2181 would help to ensure that such acquisitions would not have the negative effects already identified by the Fed in the Baldwin decision and other decisions flowing from it.

S. 2134 provides for unlimited cross-industry acquisition of thrifts by bank holding companies by striking the "proper incident test" and leaves only the question of whether an activity is "closely related" to banking up to the Fed. Since the Fed, in the Baldwin decision, has already determined that operation of an S&L is "closely related" to banking, this change in statute would, in fact, add ownership and operation of a thrift to the "laundry list" of permissible non-banking activities for bank holding companies. It would do so without imposition of any safeguards, structural or otherwise, which would be necessary to mitigate the possible adverse effects of such acquisitions. CSBS would oppose such an "open season" on cross-industry acquisitions of S&Ls by bank holding companies.

Both S. 2181 and S. 2134 would preempt the right of states to pass legislation restricting otherwise permissible non-bank activities of bank holding companies within their borders. CSBS is vehemently opposed to this incursion into the realm of state corporate law. Holding companies are not financial institutions, but corporations doing business in a state under the general corporate law of the state. Non-banking activities of a holding company are also, by definition, not creatures of the dual banking system, but of state corporate law. Court decisions on this point have held that a state may prohibit bank holding company operation within its borders and, as an adjunct thereto, may prohibit a specific, otherwise permissible non-bank subsidiary activity within its borders, so long as that prohibition is not discriminatorily applied against out-of-state bank holding companies. While the Bank Holding Company Act has preempted to some degree state authority over holding companies, it has done so traditionally only with an eye toward protecting bank subsidiaries from unwarranted risk exposure. Direct interference with state corporate law on the non-bank side is unprecedented and would operate to prevent states from limiting risk exposure of the bank holding company and its bank subsidairies where conditions in the local economy warrant such restrictions.

The balance between the Fed's initial administration of the laundry list as a national acceptable standard of risk exposure and a state's authority to determine that its local market conditions differ from those of the nation would be destroyed. It is a simple fact that what is an acceptable activity for the majority of the states may be unacceptable from a safety and soundness or a competitive standpoint in a handful of others. The beauty of the dual banking system's series of checks and balances is that both the majority and the handful can be accommodated. Destroy that symmetry and you increase risk exposure unnecessarily in that handful of states.

State Authority Over Interstate Banking

As I am sure the members of this Committee know, the Douglas Amendment to the Bank Holding Company Act prohibits bank holding companies from expanding across state lines by acquisition of a bank subsidiary, unless such acquisition is "specifically" and explicitly authorized by the state statutes of the home state of the bank to be acquired. Several states have recently acted to specifically permit interstate bank ownership pursuant to the Douglas Amendment. All but one of these states have limited or conditioned their specific authorization in some manner. The traditional view has been that states could make conditional their permission for interstate acquisition of a banking subsidiary. That view has recently been challenged, however, in the context of state statutes limiting interstate reciprocity on a regional basis. The issue is whether these state statutes create an unjustifiable burden on interstate commerce and are therefore in violation of the Commerce Clause of the Constitution.

The Commerce Clause of the Constitution is among the enumerated powers of Section 8, giving Congress the power "to regulate commerce...among the several states..." Congress can delegate its authority over interstate commerce to the states, as was done in the Douglas Amendment, Section 3(d) of the Bank Holding Company Act. The principal question is: Did Congress intend that such geographic restrictions be permitted as part of the delegation of authority to "specifically" authorize interstate acquisition? Congress can, of course, clarify the scope of its delegation by specifying that limitations such as to geographic region or conditions of entry were anticipated and that it was intended that the delegation of power be broad enough to encompass them. In the meantime, states which enact legislation in this area risk legal challenge.

We applaud the Chairman and Senator Mattingly for seeking to remove any questions now hanging over state authority in this critical area. Both Title X of S. 2181 and S. 2113 would amend the Douglas Amendment to allow states to condition entry of out-of-state holding companies "on the basis of limitations such as the geographic location or proximity of such other state or on the basis of such other state having in effect a law providing reciprocal treatment for such transactions."

CSBS questions the need for the Sunset provision contained in S. 2181, effective five years from the date of enactment, and its linkage to an administration report concerning the effect which the title has had, including legislative recommendations "as to whether the Sunset provisions...should be allowed to take effect." We are concerned both that the Sunset provision might be intended or understood to cast current state law as an "experiment" rather than as the body of pertinent law, and that, insofar as the provisions of this section are a clarification of the degree of delegation under Douglas, if they are allowed to sunset it would signal open season for lawsuits on the meaning of Douglas.

You could, of course, simply clarify the scope of Congressional delegation under the Douglas Amendment by specifying that limitations such as to geographic region or conditions of entry were anticipated and that it was intended that the delegation of power be broad enough to encompass them. CSBS would support such a clarifying amendment, even as we support the provisions of S. 2181 and S. 2113 toward that end

Other Matters of State Authority

Both S. 2181 and S. 2134 contain some provisions which are preemptive of state authority, two areas of which deserve specific comment:

- State Authority Over State-Chartered Institutions--CSBS opposes broad preemption of state authority over the powers of state-chartered non-member banks. State authority has on occasion suffered at the hands of business entrepreneurs who seek to mine the gold from loopholes in Federal or State law before they can be closed. It is interesting, therefore, that a high degree of interest has been shown in Washington towards entrepreneurial states which have sought to turn the practice to their own benefit. CSBS does not exist to pass judgment on the wisdom of individual state statutes and I will not do so today. Rather, the CSBS goal in this area is to ensure that the state system as a whole does not suffer as a result of reaction here in Washington to what has been done in individual states.

With this in mind, if there is to be a legislative reaction to certain state statutes dealing with the powers of state-chartered institutions, the Conference would prefer the narrow "rifle shot" approach of S. 2181 to any other proposals which we have seen to date. S. 2181, of course, provides that "no State may authorize banks which it charters to engage in insurance activities outside such state on a basis different from that authorized for such banks within the State." By narrowly eliminating "for-export-only" types of state insurance legislation, the bill would have minimal negative impact on the state system, given the practical realities of the current situation.

S. 2134, on the other hand, contains both less acceptable language tying the activities of state-chartered bank subsidiaries of holding companies to the Fed "laundry list" and an extension of the provisions of Glass-Steagall to all state-chartered banks. We oppose both of these provisions as overly broad, unwarranted preemptions of state authority over state-chartered institutions.

. State Usury Laws--CSBS is strongly supportive of the states' responsibility to enact laws protecting their respective citizens. Periods of economic uncertainty can cause the existence of local interest rate ceilings to seem obsolete or even appear to do harm. However, in those instances in which there is not a documented need to preempt state law, the Conference is reluctant to favor such action. In previous action taken by Congress in this area, business and agricultural credit laws of the various states have been preempted, subject to state override of the preemption. Several states exercised that override option within the prescribed time period. In that fashion users of business credit and local concerns could both be accommodated. This notwithstanding, the majority of CSBS members are opposed to preemption of state usury laws in the consumer credit area. The need to protect individual consumers, who often operate at a different level in credit transactions than do businessmen, is deemed too sensitive an issue at the state level to allow federal preemption in that area to go unchallenged.

Competitive Savings Incentive

CSBS supports the payment of interest on reserves required in conjunction with Money Market Deposit Accounts and other recently established accounts.

CSBS previously established its position on this matter in testimony on S. 353, the Federal Reserve Modernization Act of 1979, a precursor to enactment of the Monetary Control Act. While our statement endorsed no specific formula for payment of interest on reserves, CSBS did strongly urge "Congress and the Fed, in the spirit of equitable treatment of banks, to reduce significantly the unduly high reserve tax now imposed on member banks and their customers."

CSBS favored payment of interest on reserves as part of a program to reduce unreasonable membership costs so as to greatly alleviate the Fed's membership problem. We continue to believe that optional Fed membership combined with efforts to reduce membership costs is preferable to universal mandatory reserves.

In addition, bank customers would benefit from higher rates on savings and banks would better be able to compete with non-depository institutions, which do not hold reserves at the Fed. As a result of this competition, increases in super NOW accounts would both strengthen banks and increase their ability to serve the area from which they assemble their funds.

Reciprocity Under The International Banking Act of 1978

The exclusion of U.S. banks from certain foreign markets while banks from those same markets are admitted by the OCC into the U.S. strikes us as a continuing inequity. Mr. Chairman, you, Senator Hawkins, Senator Hecht and Senator Lautenberg recognized this problem in your introduction of S. 2193. At the time of introduction, you noted that while some progress has been made several "significant" exceptions exist where a substantial degree of access for U.S. banks does not exist. While recent statements by some foreign officials are encouraging, it is clear that legislative action to ensure fair treatment would be appropriate.

S. 2193 would instruct that in applications for a national charter for foreign-owned institutions under the International Banking Act, the Comptroller should take into account whether or not United States banks are permitted to conduct business in the home country of the applicant.

The Conference applauds your efforts in bringing this problem to the attention of Congress. However, we believe that the intent of the 1978 Act, the dual state/federal regulatory structure established by Congress and the requirements of equitable treatment for U.S. institutions demand more. Specifically, it should be clarified that the OCC is required by law to give full faith and credit to state laws requiring reciprocal treatment for U.S. institutions under the laws of the nation of the foreign-owned institution seeking a national charter. We would endorse such a clarification of the intent of the International Banking Act. In this fashion, the problems you cited in the introduction of S. 2193 may be addressed in an equitable fashion.

Summary And Conclusion

CSBS favors passage of comprehensive financial institution legislation, preferably on an expedited basis.

CSBS supports inclusion of the following in such a package:

(1) Some new bank and bank holding company powers.

(2) Provisions to close the non-bank bank loophole.

(3) "McFaddenization" and "Douglasization" of cross-industry acquired S&Ls.

(4) Explicit statutory recognition of the rights of states (a) to require reciprocity from foreign nations under the International Bank Act and (b) to place conditions on entry as part of the explicit permission to operate on an interstate basis under the provisions of the Douglas Amendment.

(5) Provisions of a simplified process for the formation of a bank holding company, including automatic approval where essentially nothing more is accomplished than a conversion of bank shares to holding company shares.

(6) Establishment of statutory safeguards to be applied to emergency and nonemergency acquisitions of thrifts by bank holding companies.

(7) Provisions requiring the payment of interest on reserves on new accounts.

CSBS opposes inclusion of the following in such a package:

(1) Broad preemption of state authority over the powers of state-chartered nonmember banks.

(2) Preemption of the right of an individual state to statutorily limit within its borders the permissible activities of holding companies on a non-discriminatory basis.

(3) Creation of "consumer banks", whose existence would seem to ratify rather than plug the non-bank loophole.

(4) Limitation of new powers to only bank holding company subsidiaries.

(5) Such other regulatory or industry restructuring or reform detrimental to the dual banking system as may yet be offered as amendments to an omnibus bill.

The Conference applauds your efforts, Mr. Chairman, and members of the Committee. We have a high degree of confidence in your ability to generate meaningful banking legislation in this Congress. Certainly, in S. 2181 and S. 2134 we see the building blocks for such legislation. We thank you for letting us be a part of this process.

The **Chairman**. Thank you very much, Mr. Harris. Your full statement will be printed in the record and I would say that to each of you if you would summarize your testimony because of the large number of witnesses, any inclusions in addition to your full statements will be included in the record. Mr. Wagner.

STATEMENT OF HUNTER O. WAGNER, JR., VICE PRESIDENT, BOARD OF DIRECTORS, NATIONAL ASSOCIATION OF STATE SAVINGS AND LOAN SUPERVISORS; LOUISIANA STATE COMMISSIONER OF FINANCIAL INSTITUTIONS

Mr. **Wagner**. Mr. Chairman, Senator Garn, and members of this distinguished committee, I appreciate this opportunity to provide the views of the National Association of State Savings and Loan Supervisors, more commonly referred to as NASSLS. My name is Hunter Wagner and I am commissioner of the office of financial institutions for the State of Louisiana. I appear today before you as a vice president of the National Association of State Savings and Loan Supervisors, and I might add very shortly to return to the private sector.

[The complete statement follows:]

STATEMENT OF

HUNTER O. WAGNER, JR.

COMMISSIONER OF THE DEPARTMENT OF
FINANCIAL INSTITUTIONS
STATE OF LOUISIANA

ON BEHALF OF

THE NATIONAL ASSOCIATION OF
STATE SAVINGS AND LOAN SUPERVISORS*
1983 HEARINGS ON OVERSIGHT OF DOMESTIC FINANCIAL SERVICES INDUSTRY
BEFORE
THE SENATE BANKING, HOUSING, AND URBAN AFFAIRS COMMITTEE
UNITED STATES SENATE
FEBRUARY 29, 1984

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*THE MEMBERS OF THE NATIONAL ASSOCIATION OF STATE SAVINGS AND LOAN SUPERVISORS ARE THE STATE OFFICIALS WHO REGULATE STATE-CHARTERED SAVINGS AND LOAN INSTITUTIONS IN THE SEVERAL STATES AND TERRITORIES. THE MEMBERS OF NASS&LS SUPERVISE AND EXAMINE SOME 2,300 STATE-CHARTERED INSTITUTIONS WITH ASSETS OF APPROXIMATELY $250 BILLION. THE BOARD OF DIRECTORS OF THE ASSOCIATION ARE DAVID L. PAUL, COMMISSIONER OF THE SAVINGS AND LOAN COMMISSION, STATE OF COLORADO; HUNTER O. WAGNER, JR., COMMISSIONER OF THE DEPARTMENT OF FINANCIAL INSTITUTIONS, STATE OF LOUISIANA; GEORGE F. McGUIRE, JR., DIRECTOR OF THE DIVISION OF SAVINGS AND LOAN SUPERVISION, STATE OF MISSOURI; WILLIAM B. LEWIS, DEPUTY COMMISSIONER OF THE DIVISION OF SAVINGS AND LOAN ASSOCIATIONS, STATE OF NEW JERSEY; L.L. BOWMAN, III, COMMISSIONER OF THE DEPARTMENT OF SAVINGS AND LOANS, STATE OF TEXAS; CHARLES H. BROWN, JR., DIRECTOR OF THE DIVISION OF SAVINGS AND LOANS, STATE OF MARYLAND; WALTER C. MADSEN, SUPERINTENDENT OF BANKS AND SAVINGS AND LOANS, STATE OF ARIZONA; JOHN E. MALARKEY, STATE BANK AND SAVINGS AND LOAN COMMISSIONER, STATE OF DELAWARE; AND ELAINE B. WEIS COMMISSIONER OF THE DEPARTMENT OF FINANCIAL INSTITUTIONS, STATE OF UTAH.

MR. CHAIRMAN AND MEMBERS OF THIS DISTINGUISHED COMMITTEE, I APPRECIATE THIS OPPORTUNITY TO PROVIDE THE VIEWS OF THE NATIONAL ASSOCIATION OF STATE SAVINGS AND LOAN SUPERVISORS. MY NAME IS HUNTER WAGNER, AND I AM COMMISSIONER OF THE DEPARTMENT OF FINANCIAL INSTITUTIONS FOR THE STATE OF LOUISIANA. I APPEAR TODAY BEFORE YOU AS VICE PRESIDENT OF THE NATIONAL ASSOCIATION OF STATE SAVINGS AND LOAN SUPERVISORS.

WE THANK THE CHAIRMAN AND THIS COMMITTEE FOR GIVING US THE OPPORTUNITY TO COMMENT ON S.2181, THE FINANCIAL SERVICES COMPETITIVE EQUITY ACT. MY TESTIMONY WILL ONLY FOCUS ON THOSE PROVISIONS OF S.2181 WHICH DIRECTLY AFFECT NASS&LS AND THE DUAL SYSTEM OF FINANCIAL INSTITUTION REGULATION. THE DUAL SYSTEM OF FINANCIAL INSTITUTION REGULATION AND CHOICE OF CHARTERING AUTHORITY HAS BEEN THE LIFEBLOOD AND VITALITY OF COMPETITION WITHIN THE NATION'S FINANCIAL REGULATORY STRUCTURE. THE GARN-ST GERMAIN ACT OF 1982 IS COMPELLING PROOF OF THE PRO-COMPETITIVE EFFECT OF THE DUAL SYSTEM OF FINANCIAL INSTITUTION REGULATION AND THE NEED FOR THE CONTINUANCE OF SUCH A VIABLE, DECENTRALIZED NETWORK OF FINANCIAL INSTITUTIONS.

REALIGNMENT OF THE REGULATORY FRAMEWORK OF FINANCIAL INSTITUTIONS

WE COMMEND THE MEMBERS OF THIS COMMITTEE FOR ADDRESSING IN A COMPREHENSIVE FRAMEWORK THE DIFFICULT AND CONTROVERSIAL ISSUES OF FINANCIAL INSTITUTION DEREGULATION. IT WOULD HAVE BEEN VERY EASY FOR THIS COMMITTEE TO LOOK TO THE TURMOIL OF CHANGE AND THE COMMITTEE'S ACCOMPLISHMENTS IN 1982 AND THEREBY DECIDE TO ALLOW THE MARKET TO

CONTINUE TO EVOLVE ON ITS OWN WITHOUT ANY CONGRESSIONAL GUIDANCE. RIGHTFULLY SO, THIS COMMITTEE UNDERSTANDS THAT THE LEGAL AND REGULATORY FRAMEWORK OF FINANCIAL INSTITUTIONS SHOULD NOT BE DETERMINED BY THE MARKETPLACE OR REGULATORY FIAT, BUT BY STATUTORY ACTION BASED UPON FULL AND FAIR CONSIDERATION OF ALL FACTORS. OUR ORGANIZATION SUPPORTS THE PROPOSALS IN S.2181 WHICH WOULD CHARACTERIZE INSTITUTIONS BY THE TYPE OF ACTIVITIES IN WHICH THEY ENGAGE AS WELL AS DETERMINE THE PROPER REGULATORY AGENCY TO OVERSEE SUCH INSTITUTIONS. BASICALLY, WE FEEL THAT IF AN INSTITUTION ACTS LIKE A BANK THEN IT SHOULD BE REGULATED AS ONE, WHEREAS IF AN INSTITUTION ENGAGES IN ACTIVITIES WHICH ARE GENERALLY VIEWED AS CHARACTERISTIC OF THE THRIFT INDUSTRY, THEN IT SHOULD BE REGULATED AS A THRIFT INSTITUTION REGARDLESS OF ITS NAME OR CHARTER.

WE STRONGLY ENDORSE THOSE SECTIONS OF S.2181 WHICH WOULD PROVIDE FOR THE CATEGORIZING OF FINANCIAL INSTITUTIONS WITH THE PROPER REGULATORY AUTHORITY BY SUCH INSTITUTION'S FUNCTION. A GOOD EXAMPLE OF THIS IS THE AMENDATORY PROVISION IN SECTION 108 OF S.2181, WHICH WOULD AMEND THE DEFINITION OF "INSURED INSTITUTION" IN THE SAVINGS AND LOAN HOLDING COMPANY ACT TO INCLUDE STATE-CHARTERED, FDIC-INSURED STOCK SAVINGS BANKS. THE EFFECT OF SUCH AN AMENDMENT WOULD SUBJECT THE HOLDING COMPANIES OF SUCH INSTITUTIONS TO THE PROVISIONS OF THE SAVINGS AND LOAN HOLDING COMPANY ACT AND THE AUTHORITY OF THE FEDERAL HOME LOAN BANK BOARD, RATHER THAN THE BANK HOLDING COMPANY ACT AND THE FEDERAL RESERVE BOARD. THIS DEFINITIONAL CHANGE SERVES TO REALIGN THOSE INSTITUTIONS WITHIN THE PROPER REGULATORY FRAMEWORK

BASED UPON THEIR ACTIVITIES IN THE FINANCIAL MARKETPLACE AND NOT BASED UPON THEIR NAME OR TYPE OF CHARTER.

THRIFTNESS TEST

WE ALSO STRONGLY SUPPORT THE DEFINITIONAL TEST OF A "QUALIFIED THRIFT LENDER" PROPOSED IN S.2181 IN SETTING MINIMUM GUIDELINES FOR DETERMINING WHETHER A PARTICULAR INSTITUTION IS A THRIFT. NASS&LS BELIEVES THAT THE PRIMARY ROLE OF THRIFT INSTITUTIONS IS TO SERVE THE HOUSING FINANCE NEEDS OF THE AMERICAN PEOPLE. IF THESE NEEDS ARE NOT BEING MET BY A PARTICULAR INSTITUTION DUE TO A CONCENTRATION OF ITS INVESTMENTS IN OTHER AREAS, THEN PERHAPS THE INSTITUTION SHOULD BE FORCED TO DECIDE THE TYPE OF SERVICES AND REGULATORY FRAMEWORK IN WHICH IT WANTS TO OPERATE. S.2181 WOULD ASSIST SUCH INSTITUTION IN MAKING THE DECISION.

ALTHOUGH NASS&LS SUPPORTS THE THRIFT INDUSTRY'S COMMITMENT TO HOUSING FINANCE, DIVERSIFIED INVESTMENT AUTHORITY IS CRITICAL TO THE LONG-TERM VIABILITY OF THE THRIFT INDUSTRY. THIS NEED FOR DIVERSIFICATION WAS CLEARLY RECOGNIZED IN THE GARN-ST GERMAIN ACT WHICH ENABLED FEDERAL THRIFT INSTITUTIONS TO INVOLVE THEMSELVES IN COMMERCIAL LENDING AND OTHER BANK-LIKE ACTIVITIES IN A LIMITED WAY IN ORDER TO PERMIT SUCH INSTITUTIONS TO EFFECTIVELY COMPETE IN THE FINANCIAL MARKETS. THESE SPECIFIC PROVISIONS, WHICH ARE ENJOYED BY MANY STATE-CHARTERED INSTITUTIONS, BY SPECIFIC STATE LAW OR PARITY STATUTES, PROVIDE A NEW MEASURE OF ASSET FLEXIBILITY TO SUPPLEMENT

THEIR PRINCIPAL ROLE OF MORTGAGE AND REAL ESTATE FINANCE. ALTHOUGH THESE ADDITIONAL POWERS HAVE ENABLED SUCH INSTITUTIONS TO COMPETE IN THE NEW FINANCIAL SERVICES ENVIRONMENT, IT IS IMPERATIVE THAT WE RECOGNIZE THAT OUR INDUSTRY IS STILL COMMITTED TO OFFERING AND INVESTING IN HOME MORTGAGE AND HOUSING FINANCE. NASS&LS AND THE INSTITUTIONS WE REGULATE RECOGNIZE AND ENDORSE THE NEED FOR THIS CONTINUING COMMITMENT. HOWEVER, WE ALSO RECOGNIZE THE FACT THAT OUR INDUSTRY IS STILL EXTREMELY FRAGILE AND THAT A BALANCE MUST BE STRUCK BETWEEN THE NEED FOR HOUSING FINANCE AND THE NEED FOR INSTITUTIONS TO DIVERSIFY THEIR INVESTMENTS IN ORDER TO ASSURE THEIR CONTINUING SAFETY AND SOUNDNESS.

IN KEEPING WITH OUR ENDORSEMENT OF HOUSING FINANCE AS A DIRECTION FOR THE THRIFT INDUSTRY AND IN ORDER TO ASSURE THE SAFETY AND SOUNDNESS OF SUCH INSTITUTIONS, WE ARE WORKING WITH THE STAFF OF THE FEDERAL HOME LOAN BANK BOARD WHICH IS CONSIDERING RECOMMENDING THE ADOPTION OF REGULATIONS WHICH WOULD REGULATE NON-MORTGAGE RELATED INVESTMENT AUTHORITY OF FSLIC-INSURED INSTITUTIONS. THE THRUST OF THE REGULATIONS WOULD BE TO ESTABLISH A MINIMUM INVESTMENT IN RESIDENTIAL RELATED MORTGAGES BY INSURED INSTITUTIONS AND CURTAIL THE INVESTMENT AUTHORITY OF A STATE-CHARTERED INSTITUTION IF THE SAFETY AND SOUNDNESS OF SUCH INSTITUTION WERE IN QUESTION DUE TO THE TYPES OF LOANS AND INVESTMENTS MADE AND THE LEVEL OF ADEQUACY OF ITS RESERVES. SIMPLY STATED, WITH EXPANDED INVESTMENT AUTHORITY, THRIFT REGULATORS MUST NOW LOOK MORE CLOSELY AT ASSET RISK AS WELL AS

INTEREST RATE RISK. NEVERTHELESS, WE DO BELIEVE THAT DIVERSIFICATION OF INVESTMENTS TO A CERTAIN EXTENT IS NECESSARY FOR THE INDUSTRY TO AVOID THE DEVASTATING MIS-MATCHING OF ITS ASSETS AND LIABILITIES. THE INDUSTRY RECENTLY EXPERIENCED THE IMPACT OF SUCH MISMATCHING AND WE HAVE AN OBLIGATION AS REGULATORS TO ASSIST THE INDUSTRY IN MINIMIZING ITS VULNERABILITY TO INTEREST RATE SWINGS. WE HAVE REVIEWED THE SUGGESTIONS PROPOSED IN OTHER BILLS AND BY INDUSTRY REPRESENTATIVES AS TO WHAT THE MINIMUM COMMITMENT TO HOUSING FINANCE SHOULD BE AND WE ENDORSE THE "QUALIFIED THRIFT LENDER" TEST IN S.2181 AS MEETING THE BALANCE NEEDED BETWEEN DIVERSIFICATION AND HOUSING.

PAYMENT OF INTEREST ON DEMAND DEPOSITS

WE ALSO SUPPORT THE PAYMENT OF INTEREST BY DEPOSITORY INSTITUTIONS ON DEMAND DEPOSITS. AN ESSENTIAL ROLE AND RESPONSIBILITY OF A DEPOSITORY INSTITUTION HAS BEEN TO MARKET AND GATHER DEPOSITS. CURRENTLY, HOWEVER, MOST THRIFT INSTITUTIONS ARE BASICALLY LIMITED TO OFFERING DEMAND DEPOSITS ONLY TO THOSE BUSINESS CUSTOMERS WITH WHICH THE INSTITUTION HAS A LOAN RELATIONSHIP. THE PROVISION IN S.2181 WOULD ONLY PERMIT THE PAYMENT OF INTEREST ON THOSE LIMITED TYPES OF DEMAND DEPOSITS. IF THIS RESTRAINT COULD BE REMOVED IN CONJUNCTION WITH ALLOWING INTEREST ON DEMAND DEPOSITS, THRIFT INSTITUTIONS WOULD BE ABLE TO COMPETE FOR DEPOSIT DOLLARS, FOR THE FIRST TIME, ON AN EQUITABLE BASIS WITH COMMERICAL BANKS. AS WE ALL ACKNOWLEDGE, SUCH DEPOSIT DOLLARS ARE A NECESSARY MEANS TO ENABLE INSTITUTIONS TO CONTINUE TO PROVIDE MONEY FOR HOUSING. THE COMPETITIVE BENEFITS THAT HAVE ALREADY ACCRUED TO THE INDUSTRY IN LIGHT

OF THE MMDA AND NOW ACCOUNTS ARE THE MOST PERSUASIVE ARGUMENT FOR CONTINUED DERGULATION IN THIS AREA. A SUBSTANTIAL PART OF THE GROWTH IN RETAIL DEPOSIT BALANCES IN THRIFT INSTITUTIONS REPRESENTS FUNDS PLACED IN THESE TWO ACCOUNTS. THEREFORE, WE URGE THE COMMITTEE TO REMOVE THE CURRENT DEMAND DEPOSIT OFFERING RESTRAINT AND THE PROHIBITION ON THE PAYMENT OF INTEREST ON DEMAND DEPOSITS. THE REMOVAL OF THESE RESTRICTIONS WOULD PROVIDE BENEFITS IN COMPETITIVE EFFICIENCY AND CONSUMER CHOICE WHICH WOULD FAR OUTWEIGH ANY TRADITIONAL EARNINGS PRESSURE ON FINANCIAL INSTITUTIONS. IN ADDITION, IT WOULD PERMIT THRIFT INSTITUTIONS TO TRULY COMPETE AND SOLICIT DEPOSITS ON THE SAME BASIS AS COMMERCIAL BANKS.

ON A RELATED ISSUE, NASS&LS SUPPORT INITIATIVES TO REQUIRE THE FEDERAL RESERVE BOARD TO PAY INTEREST ON RESERVES NOW HELD AGAINST DEMAND DEPOSITS. PAYING INTEREST ON THESE FUNDS WOULD HELP TO OFFSET THE INCREASED COST FOR FUNDS ACCOMPANYING DEMAND ACCOUNT DEREGULATION, AND WOULD ALLOW DEPOSITORIES TO PASS COST SAVINGS ALONG TO CUSTOMERS.

DEFINITION OF THE TERM "BANK"

WE WOULD ALSO LIKE TO ADDRESS THE EXPANSION OF THE DEFINITION OF THE TERM BANK FOR PURPOSES OF THE BANK HOLDING COMPANY ACT. IN REVIEWING SECTION 104 OF S.2181, WE ARE UNABLE TO DETERMINE WHETHER THE DEFINITION IS INTENDED TO INCLUDE STATE-CHARTERED SAVINGS AND

LOAN ASSOCIATIONS, WHICH ARE NOT FEDERALLY INSURED. IT APPEARS THAT THE INTENT OF THE LANGUAGE, WHICH EXCLUDES AN "INSTITUTION OPERATED IN THE MANNER AUTHORIZED BY STATE THAT DOES NOT BOTH ENGAGE IN THE BUSINESS OF MAKING COMMERCIAL LOANS AND ACCEPTING DEMAND DEPOSITS", IS TO EXCEPT SUCH STATE-CHARTERED NON-FEDERALLY INSURED INSTITUTIONS FROM THE DEFINITION. HOWEVER, WE BELIEVE THERE TO BE SOME AMBIGUITY BETWEEN THIS EXCLUSIONARY LANGUAGE AND OTHER LANGUAGE IN THE SECTION WHICH APPEARS TO INCLUDE SUCH INSTITUTIONS IN THE DEFINITION.

WE RESPECTFULLY REQUEST THAT THIS SECTION BE CLARIFIED TO INDICATE THAT SUCH THRIFT INSTITUTIONS ARE NOT TO BE INCLUDED WITHIN THE DEFINITION. CLEARLY SUCH INCLUSION WOULD BE IN CONTRAVENTION OF THE PHILOSOPHICAL INTENT OF THIS LEGISLATION TO DIFFERENTIATE BETWEEN INSTITUTIONS BASED ON ACTIVITIES AND ALIGN THOSE INSTITUTIONS WITH THE PROPER REGULATORY AUTHORITIES.

NASS&LS SIMPLY CANNOT ACCEPT THAT THE RIGHT TO ACCEPT TRANSACTION ACCOUNTS AND ENGAGE IN THE BUSINESS OF MAKING COMMERCIAL LOANS TRANSFORMS A SMALL THRIFT INSTITUTION CHARTERED AND INSURED UNDER LEGITIMATE STATE STATUTE INTO A BANK. SINCE MANY OF THESE THRIFT INSTITUTIONS ARE OWNED BY HOLDING COMPANIES, THESE HOLDING COMPANIES WOULD BECOME BANK HOLDING COMPANIES. AS A RESULT, THEY WOULD BE SUBJECT TO ALL THE RESTRICTIONS AND REGULATION THAT SUCH A DESIGNATION ENTAILS OR BE REQUIRED TO DIVEST THEMSELVES OF THEIR SUBSIDIARY SAVINGS AND LOAN ASSOCIATIONS. THEIR SUBSIDIARY INSTITUTIONS

WOULD ALSO BE REQUIRED TO OBTAIN FDIC-INSURANCE. THIS WOULD BE A TREMENDOUS INEQUITY TO SUCH INSTITUTIONS WHICH ARE SMALL, LOCALLY-ORIENTED FINANCIAL INSTITUTIONS IN REQUIRING THEM TO UNDER GO THE FINANCIAL AND ADMINISTRATIVE BURDENS ASSOCIATED WITH THE BANK HOLDING COMPANY ACT AND THE REPORTING REQUIREMENTS THEREUNDER. AS YOU MAY KNOW, MANY OF THESE INSTITUTIONS ARE INSURED BY PRIVATE DEPOSIT INSURANCE FUNDS. LEGISLATION OF THIS NATURE WOULD SURELY HAVE A SIGNIFICANT AND DETRIMENTAL EFFECT ON THESE INSURANCE FUNDS, AND POSSIBLY MAY LEAD TO THE POTENTIAL DEMISE OF SUCH PROGRAMS WHICH HAVE BEEN A SUCCESSFUL ALTERNATIVE TO FEDERAL INSURANCE PROGRAMS.

IT IS OUR FURTHER UNDERSTANDING THAT SUCH INSTITUTIONS WOULD ALSO BE INAPPROPRIATELY DEEMED BANKS FOR PURPOSES OF THE BANK HOLDING COMPANY ACT IN S.2134, THE DEPOSITORY INSTITUTIONS HOLDING COMPANY ACT AMENDMENTS, AND REGULATION Y AS RECENTLY AMENDED BY THE FEDERAL RESERVE BOARD. CERTAINLY IT IS NOT THE INTENT OF THIS COMMITTEE TO PLACE SUCH BURDENS ON THESE INSTITUTIONS AND THE PROGRAMS WHICH INSURE THEM. THEREFORE, WE URGE THE COMMITTEE TO SPECIFICALLY EXCLUDE STATE-CHARTERED, NON-FEDERALLY INSURED INSTITUTIONS FROM THE DEFINITION OF THE TERM BANK. FURTHERMORE, WE ASK THE COMMITTEE TO PETITION THE FEDERAL RESERVE BOARD TO AMEND ITS DEFINITION OF REGULATION Y TO SPECIFICALLY EXCLUDE STATE-CHARTERED, NON-FEDERALLY INSURED INSTITUTIONS FROM ITS DEFINITION OF BANK.

INTERSTATE BRANCHING

A FINAL ISSUE WHICH NASS&LS FEELS MOST STRONG ABOUT IS GEOGRAPHIC REALIGNMENT OF FINANCIAL INSTITUTIONS. SPECIFICALLY WE ARE CONCERNED ABOUT INTERSTATE COMBINATIONS AND INTERSTATE BRANCHING. CENTRALIZATION OF THE NATION'S FINANCIAL RESOURCES IS A THREAT TO THE VERY SYSTEM WHICH HAS SERVED THIS COUNTRY SO WELL. SINCE 1976, NASS&LS HAS OPPOSED THE POLICY OF INTERSTATE BRANCHING FOR FEDERAL SAVINGS AND LOAN ASSOCIATIONS LAST YEAR WHEN WE WERF BEFORE THIS COMMITTEE WE AGAIN ADDRESSED THE ISSUE OF INTERSTATE BRANCHING. ALTHOUGH CONGRESS HAS AUTHORIZED INTERSTATE BRANCHING FOR FEDERAL ASSOCIATIONS IN THE GARN-ST GERMAIN ACT, WE FEEL THAT CONGRESS SHOULD PLACE THE ISSUE OF INTERSTATE BRANCHING AND ACQUISITION IN THE PROPER PERSPECTIVE. OUR POSITION REMAINS THAT, PRIOR TO ENTRY BY AN OUT-OF-STATE INSTITUTION, THE STATE INTO WHICH THE INSTITUTION IS BRANCHING WOULD CERTIFY THAT ITS LAWS PERMIT SUCH ENTRY. WE ARE MOST PLEASED TO SEE THAT S.2181 WOULD REQUIRE STATE LAW CERTIFICATION.

WE WOULD LIKE TO THANK YOU FOR THIS OPPORTUNITY TO PRESENT OUR VIEWS AND LOOK FORWARD TO RESPONDING TO ANY QUESTIONS WHICH YOU MIGHT HAVE CONCERNING OUR POSITION ON S.2181.

The CHAIRMAN. Thank you, Mr. Wagner.

Mr. Foudree.

STATEMENT OF BRUCE W. FOUDREE, CHAIRMAN, INTEGRATED FINANCIAL SERVICES TASK FORCE, NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS; IOWA STATE INSURANCE COMMISSIONER

Mr. FOUDREE. Mr. Chairman, members of the committee, the NAIC appreciates this opportunity to comment on S. 2181. As you may recall, the NAIC previously submitted a statement to this committee on May 20, 1983, which outlines our position on the integration of financial services. Commissioner Roger Day also addressed general concerns with S. 2181 in Salt Lake City on January 16, 1984. Today, we would like to supplement those comments by pointing out specific concerns with the bill.

I might note that our comments are directed only to those parts of the bill which relate to insurance and insurance regulation.

[The complete statement follows:]

Statement of the
National Association of Insurance Commissioners

Submitted to the
U.S. Senate Committee on Banking, Housing & Urban Affairs

by
Bruce W. Foudree
Insurance Commissioner of the State of Iowa

and
Vice-President of the NAIC and
Chairman of the NAIC Integrated Financial Services Task Force

February 29, 1984

The NAIC appreciates this opportunity to comment on S. 2181. As you may recall, the NAIC previously submitted a statement to this Committee on May 20, 1983, which outlines our position on the integration of financial services. Commissioner Roger Day (Utah) also addressed general concerns with S. 2181 in Salt Lake City, January 16, 1984. Today, we would like to supplement those comments by pointing out specific concerns with the bill.

First, the legislation goes too far by allowing banks to engage in insurance underwriting (Section 104d). Our primary concern is the impact this would have on the ability of the states to effectively monitor for financial solvency. Similarly, we are not presently persuaded that consumers will benefit if banks are permitted to directly engage in the brokering or marketing of insurance products. The marketplace is already crowded and marked by excess capacity. Insurance regulators are not convinced that allowing underwriting and brokering by banks will improve competition or, consumer convenience, achieve significant cost savings, or permit effective regulatory oversight of industry activities. The burden of demonstrating these is on those who would change the current regulatory framework, and it has not yet been met. We stand firm in our view that a statutory framework designed to protect the public should not be dismantled without first studying the likely consequences and without having in place a definite structure to respond to industry behavior that is likely to occur. Longstanding solvency safeguards should not be sacrificed for the sake of consumer convenience.

Several sections of the bill could result in federal pre-emption of state insurance regulation. For example, section 104 provides for Board application of criteria in approval of acquisitions; Board power to limit the insurance activity of bank holding companies; the right to require reports (which would not only duplicate but pre-empt state regulation if the Federal Reserve Board has the final say on report content); the right of the Board to make examinations; and section 105, by providing that a bank or its subsidiaries "may" engage in certain transactions, could result in conflicts with state laws such as the Insurance Holding Company Act. Specifically, after being given sixty days notice, the Federal Reserve Board may disapprove a bank holding company's proposal to acquire an insurer if certain statutory criteria are not met. Among these are the managerial resources of the companies involved, the adequacy of their financial resources, and any material adverse effect on the safety and soundness or financial condition of an affiliated bank. Obviously, there are possible areas of overlap between the bill and the provision of the NAIC Insurance Holding Company System Regulatory Act dealing with acquisitions of domestic insurers (S3) and thus a possible preemption issue arises just as it has in Williams Act situations. See generally, Nat'l City Lines, Inc. v. LLC Corp., 524 F. Supp. 906 (W.D. Mo. 1981).

Unlike the Treasury Department's bill, S. 2181 attempts to place a number of consumer protections upon the practice of banks selling insurance. For example, a bank must explain in writing to a person who is attempting to obtain credit for a transaction in which insurance is or may be required that the insurance may be purchased from an insurer or agent of the person's choice, and the bank is precluded from directly or indirectly soliciting insurance until it has given the potential borrower a commitment in writing that credit will be extended. See section 107 of the Garn Act. A bank may not unreasonably reject a contract of insurance furnished by the borrower covering the collateral for the loan, nor reject the contract without giving the borrower a statement in writing of the reasons for the rejection, nor require the borrower or its insurer or agent to pay a separate charge in connection with the handling of the insurance required to obtain the loan. Id. Moreover, the borrower may cancel the insurance obtained from a bank within thirty days and is entitled to a refund of the unearned premium. A serious question exists as to whether these "protections" are in fact adequate to discourage banks from engaging in the practice of tie-ins, with all their attendant abuses. For example, the bill does not specify the time when notice must be given that insurance may be purchased from the insurer and agent of one's choice. While it is laudable to prohibit a bank from soliciting insurance until after a loan commitment has been made, it would be very difficult to enforce this provision and a loan officer, through subtle suggestions, could obviously create pressure upon the potential borrower to obtain insurance from the bank. The borrower's right to cancel the bank's policy and obtain a refund is equally hollow, since it would result in the borrower being in default on the loan agreement if he failed to promptly obtain other insurance.

While the bill does place some limits on the degree to which a bank holding company might enter the business of insurance—the federal reserve board may (with emphasis on the "may") place general limitations upon the new types of activities, including insurance, allowed for bank holding companies, and a bank holding company with more than .3% of the nation's deposits may not invest in any one type of new activity if its investment therein would exceed five percent of the consolidated assets of the bank holding company--the limitations are insignificant and give virtual carte blanche authority for bank holding companies to enter the insurance field. A concomitant increased concentration of financial risks is thereby produced.

The language in section 105 governing transactions with affiliates is much weaker than the protections, restrictions, and standards currently found in the Model Insurance Holding Company Act adopted by the states. Stronger controls on asset and dividend transfers are desirable.

While S. 2181 appears to have the goals of protecting the assets of banks or bank holding companies and assuring fair competition, the state insurance laws focus on protecting the assets of insurers and their insureds as well as maintaining fair trade practices by those insurers. The states are currently in the process of developing modifications in existing insurance laws to respond to perceived problems resulting from changes in the marketplace. New modes of regulation, or new tools, are being considered. Our principal objectives are to monitor and maintain the financial integrity of insurers and to enforce fair treatment of consumers in the marketplace. To the extent that marketing practices and proposed changes in federal law have the potential to affect our ability to achieve those goals, we will naturally take a strong interest in them to assure that the protection of the public is not diminished. Because the impact of dismantling or altering the present regulatory structure is likely to be profound, we must act with exceptional care. Our obligation to the public is very high. Unless we first ask whether, and to what extent, deregulation and the integration of financial services institutions is truly desirable by first weighing the perceived benefits against historical and potential adverse effects, we will not have fulfilled our role as fiduciaries of the public interest.

The **CHAIRMAN**. Thank you, Mr. Foudree.
Mr. Unger.

STATEMENT OF MICHAEL UNGER, PRESIDENT, NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION; DIRECTOR, MASSACHUSETTS SECURITIES DIVISION, ACCOMPANIED BY FRANKLIN TOM, CHAIRMAN, FINANCIAL INSTITUTIONS COMMITTEE, NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION; CALIFORNIA STATE COMMISSIONER OF CORPORATIONS

[The complete statement follows:]

Mr. Chairman and Members of the Committee:

I am Michael Unger, President of the North American Securities Administrators Association (NASAA). NASAA is the association of the 65 state and provincial securities administrators from the United States, Canada and Mexico, charged with the responsibility of administering and enforcing securities laws in their jurisdictions. NASAA works to protect investors and to ensure that the securities markets operate smoothly, efficiently and with the minimum of abuse.

NASAA believes that the recent changes in the marketplace which foster competition to the benefit of consumers of financial services are desirable. However, NASAA is concerned about the preservation of and adherence to the elements of investor protection which are an integral part of state and federal securities regulation.

NASAA's members recognize that the basic policy decisions in this area will be made on the federal level, but that the states will be directly affected by those policies. State securities administrators will have to deal with the consequences of such decisions and very likely adjust their own policies of state securities laws to complement federal policy. For this reason, we have kept pace with recent changes in the marketplace. Last year, NASAA held a Financial Institutions Forum here in Washington which was attended by federal and state securities regulators, representatives of the banking and securities industry and congressional staff in order to grapple with this issue. Since that Forum, we have responded to the Bush Task Group and testified before this Committee on the possible impact, particularly on state securities regulation, of the expanded securities activities of banks and other financial institutions. Most recently, we have responded to the invitiation of the Securities and Exchange Commission to comment upon the Commission's proposed rule to, in effect, impose the Commission's broker-dealer regulations upon the securities operations of banks.

With me today is Franklin Tom, Chairman of NASAA's Financial Institutions Committee. Mr. Tom will present NASSA's position on S. 2181, the Financial Services Competitive Equity Act.

Mr. Chairman and Members of the Committee:

Having reviewed the Financial Services Competitive Equity Act, I have heretofore relayed to the staff of this Committee my detailed and technical comments for their consideration in order to avoid taking the Committee's time on such matters. This morning, I would like to utilize the time allotted to us to underscore NASAA's long-standing basic policy positions, insofar as they relate of S. 2181, which are fully consistent with the testimony given last year to this committee by my predecessor at NASAA.

Regulation of Securities Operations of Depository Institutions

NASAA has long held the position that securities brokerage, underwriting and advisory services should be regulated by the administrator of securities laws regardless of whether the regulated entity was itself a depository institution. In this way, the government can best ensure that the procedures designed to protect investors will aply to all those who engage in the securities business. At the same time, this policy would foster uniformity of regulation among all institutions which compete for securities business and which, in the public's eyes, are interchangeable alternatives.

This regulatory policy - often referred to as regulation by function - has been espoused by the North American Securities Administrators Association ever since the securities business began blending into other financial businesses. We are pleased to note that this view has been accepted by the Bush Task Group in its recent report, and that it is the foundation of the Securities and Exchange Commission's recent proposal on broker-dealer regulation of the securities activities of banks.

We at NASAA are mindful of the traditional role played by depository institutions in providing accommodative securities services to their customers. We believe that these traditional services should be permitted without subjecting the institution to broker-dealer licensing and regulation because the existing regulatory structure for financial institutions appears to have been adequate to protect the public interest in these limited transactions. Indeed, in our recent comment letter to the Securities and Exchange Commission, a copy of which we have heretofore furnished to your staff, we made this point with all appropriate emphasis.

Moreover, NASAA has always favored an open door policy with respect to the securities business. We approve of the movement of depository institutions and other organizations into the securities business because it will increase the public availability of securities services and will add a healthy degree of competition which may inure to the public benefit in the form of reduced transaction costs and other benefits. Of course, the securities activities must be consistent with safety and soundness standards applicable to depository institutions. On this matter, we defer to the experience and expertise of the federal and state regulators of depository institutions. In addition, the securities activities of depository institutions must be subject to the same regulatory oversight that its competitors in that business are subject to.

The proposals set forth in the Bill will make major strides in the direction of regulation by function. NASAA applaudes that progress. As we understand it, the Bill provides that any bank holding company and any bank which is a member of the Federal Reserve System and which wishes to utilize the authority provided under the Bill for expanded securities services must operate those securities activities in an organization meeting the definition of a depository institution securities affiliate

("DISA"). Such a DISA, since it cannot be the bank itself, would be subject to federal and state securities regulation of broker-dealers so long as its activities fall within the definitional ambit of a broker or dealer. In other words, the express exemption from broker-dealer definitions accorded to banks under the Securities Exchange Act of 1934 and under most state securities laws would not be available to the DISA since it would not be a bank.

We suggest, however, that there may be a gap in the Bill's coverage of securities activities of banks. That gap occurs with respect to banks which are not members of the Federal Reserve System and which are not in a holding company structure, but may, to a limited extent, engage in securities businesses.

We commend for this Committee's consideration additional amendments to the Securities Exchange Act of 1934 in order to adopt the approach taken by the Securities and Exchange Commission in its recently proposed rule on bank-related securities activities. In the proposed rule, the Commission seeks to remove from the term "bank" those banking institutions which engage in certain categories of securities services. Those are (1) public solicitation of brokerage business, (2) performance of services in which compensation is transaction-based, and (3) certain underwriting activity.

The advantage of the Commission's approach is that it does not distinguish among banks based upon their organizational structure or their chartering. While NASAA does not believe the Commission's proposal to be flawless - our comment letter to the Commission includes several suggested changes - we strongly believe the approach to be correct.

Our suggestion to this Committee to include amendments to the Securities Exchange Act of 1934 are being made today notwithstanding the fact that the Commission has commenced its rule-making on this subject. The reason is that the Commission's authority to promulgate the proposed rule has been questioned by some commentators. It is likely that court challenges of extended duration would ensue if the Commission adopts its proposed rule. The uncertainty that would exist during the protacted litigation period would foster the very disequilibrium that the Bill seeks to rectify. By including the Commission's approach in this Bill, Congress would moot the issue of the Commission's authority and thus substitute clarity for uncertainity. A clear grant of regulatory authority to the Commission for the brokerage activities of depository institutions would establish uniformity of regulation at the federal level. and would also establish a critically important model for the states as they consider this same subject.

Regulation of Investment Companies Affiliated With Depository Institutions

NASAA would also like to devote a few minutes to the regulatory issues resulting from the Bill's proposal to permit bank-affiliated mutual funds. At the time the Investment Company Act of 1940 was adopted, considerable attention was paid to conflict of interest potentials. With the advent of bank-sponsored mutual funds - a liaison not envisioned in the original Act - a close review of the conflict provisions is in order because of the existence of the potential of investor harm resulting from the relationship of banks to mutual funds.

The Bill addresses three of the potential hazards. But the three suggested amendments do not address the conflict issues in comprehensive form. For example, a fund's investment in a corporation which has significant borrowing from the sponsoring bank could be abusive under certain circumstances.

Of course, we recognize that any such limitations along the lines we are suggesting must be carefully considered to balance conflict potentials on the one hand against competitive considerations on the other. In this regard, we suggest that it may be appropriate to limit any to those transactions only where certain thresholds of materiality are reached. Unfortunately, we are unable to make more than suggestions in principle, lacking hard data and having inadequate research time to develop more concrete proposals. We would be happy, however, to work with your staff in this regard if the Committee is favorably disposed to our suggestions and believe NASAA's input will be helpful.

Conclusion

Mr. Chairman, Mr. Unger and I are appreciative of the Committee's invitation to testify at these hearings. We hope that our remarks have been useful, and we welcome the opportunity to provide the Committee with any additional information which it may seek.

Testimony of Michael Unger and Franklin Tom
North American Securities Administrators Association

Summary of Remarks

The North American Securities Administrators Association (NASAA) has long espoused the principle that those engaged in the securities business should be subject to the same regulatory standards, applied uniformly by the same agency which regulates all such businesses, regardless of whether or not such business is affiliated with a depository institution. Thus, on the federal level, the Securities and Exchange Commission (SEC) should be the regulatory agency regulating not only independent brokerage firms and investment bankers, but also those affiliated with banks and savings and loans. Accordingly, NASAA commends the Committee on S. 2181 which generally requires banks and savings associations to form a depository institution securities affiliate (DISA) to conduct the expanded securities authority permitted by the Act. In particular, the separation of the DISA from the depository institution is especially welcomed because it will simplify the regulatory separation of the securities business from the banking business. In addition, such separation will foster safety and soundness standards which are the principles of banking regulation.

However, the Bill apparently does not address the regulation of the securities business conducted by banks without holding companies if the securities business does not take an expanded scope as authorized by S. 2181. NASAA commends to the Committee the approach taken by the Securities and Exchange Commission in tis proposed rule to regulate the broker-dealer activity of banks. This approach, if taken legislatively in this Bill, could use the same format of defining the term "bank" to exclude those engaged in public securities business and underwriting business.

NASAA also expressses some general concerns about the adequacy of the provisions of the Bill amending the Investment Company Act of 1940. Since depository institutions were not allowed to sponsor or sell mutual funds at the time the Investment Company Act was enacted, no need existed to consider conflict of interest potentials between banks and mutual even though the Act includes conflict provisions on other relationships.

For example, we believe that consideration should be given to including prohibitions against mutual fund purchases of certain securities in which the sponsoring bank is a material lender to the same issurer.

The **Chairman**. Thank you.
Mr. Burge.

STATEMENT OF CHARLES W. BURGE, PRESIDENT, NATIONAL ASSOCIATION OF STATE CREDIT UNION SUPERVISORS; GEORGIA STATE DEPUTY COMMISSIONER FOR THRIFT INSTITUTIONS

[The complete statement follows:]

INTRODUCTION

Mr. Chairman, my name is Charles Burge. I am President of the National Association of State Credit Union Supervisors (NASCUS) and Deputy Commissioner of Thrift Institutions for the State of Georgia.

The National Association of State Credit Union Supervisors is the association of all forty-seven state credit union supervisory departments, plus the Commonwealth of Puerto Rico. Our members are responsible for chartering, regulating and supervising the nation's 8,500 state-chartered credit unions.

We appreciate the invitation and opportunity to appear before your committee today. Our testimony will be very narrow in focus, as we have chosen to comment only on the issues that have a direct impact on state supervision of credit unions.

NCUSIF CAPITALIZATION PLAN

NASCUS is unanimously in favor of the 1% minimum capitalization goal for the National Credit Union Share Insurance Fund (NCUSIF) as embodied in S.2121. Although, we do not endorse any specific plan to reach this minimum level, believing the method properly to be an industry-only issue, we feel that an adequate capital base is mandatory for a strong share insurance fund. The capitalization plan as proposed is substantially similar to the capitalization plan used by my home state's share insurance fund (Georgia Deposit Insurance Corporation), as well as a majority of the other state share guaranty corporations across the country.

As you are aware, credit unions are now, for the most part, completely deregulated. The removal of government restraints on both the asset and liability sides of the balance sheet greatly increases the possibility of bad business judgment and corresponding losses. Throughout the thirteen (13) years of its existence, the NCUSIF has frequently been an effective tool in working out and rehabilitating problem credit unions. In order to handle these potential, additional problems in the credit union system, we feel that it is imperative that the NCUSIF achieve its capitalization goal.

At present, credit unions throughout this country are, for the most part, in good financial condition. This is the opportune moment to implement such a capitalization plan.

CREDITORS PRIORITY

We feel that Sections 14 and 15 should be removed from S.2121, as they are not related to the capitalization issue.

We are unalterably opposed to Section 15 of S.2121, which seeks to pre-empt state law with respect to creditor priority payout schedules for an involuntarily-liquidating, federally-insured/state-chartered credit union. This section itself seems harmless enough, but if you are aware of the history that has led the NCUA to seek its enactment, you will understand how far-reaching its consequences will be and thus why our objections are so strong.

Late last year the NCUA sought to pre-empt state law on creditor priority by issuing a regulation. Our trade association and the Credit Union National Association (CUNA) jointly filed suit.

IN ITS DECISION, THE COURT SAID THAT THE NCUA HAD NOT FOLLOWED THE ADMINISTRATIVE PROCEDURES ACT, AND THE PROPOSED REGULATION WAS INVALIDATED.

IT HAS BEEN THE UNBROKEN PRECEDENT IN THE BANKING INDUSTRY, DURING THE MORE THAN FIFTY- (50) YEAR OPERATION OF THE FDIC, FOR THAT AGENCY TO DEFER TO STATE LAW IN THE CASE OF DETERMINING CREDITOR PRIORITY PAYOUT SCHEDULES IN AN INVOLUNTARILY-LIQUIDATING, FEDERALLY-INSURED/STATE-CHARTERED BANK. FOR THE PAST THIRTEEN (13) YEARS, SINCE THE ESTABLISHMENT OF THE NCUSIF, IT HAS SIMILARLY BEEN THE PRECEDENT TO FOLLOW STATE LAW WHEN DETERMINING THE PAYOUT SCHEDULE FOR AN INVOLUNTARILY-LIQUIDATING, FEDERALLY-INSURED/STATE-CHARTERED CREDIT UNION.

WE FEEL THAT THE ISSUE OF DETERMINING CREDITOR PRIORITY IN AN INVOLUNTARY PAYOUT OF A FEDERALLY-INSURED/STATE-CHARTERED CREDIT UNION SHOULD REMAIN THE PREROGATIVE OF THE STATE IN WHICH THE CREDIT UNION CHOOSES TO BECOME CHARTERED. FOR FEDERAL PRE-EMPTION OF STATE LAWS TO OCCUR IN THESE INSTANCES PRESENTS US WITH A PRECEDENT THAT COULD MAKE SUCH INTRUSIONS FREQUENT OCCURRENCES IN THE FUTURE. IT WOULD NOT TAKE MANY OF THESE -- MAYBE NO MORE THAN THE FIRST ONE -- TO SERIOUSLY THREATEN THE INTEGRITY OF STATE LAWS AND WITH IT THE VIABILITY OF THE DUAL CHARTERING SYSTEM. ULTIMATELY, IT IS THE AMERICAN CONSUMER WHO WILL PAY -- AND A VERY HIGH PRICE, INDEED -- FOR THE LOSS OF THIS OPTION.

S.2181
TITLE II
CREDIT UNION
AMENDMENTS

THE FINANCIAL SERVICES COMPETITION EQUITY ACT

WITH RESPECT TO S.2181, THE FINANCIAL SERVICES COMPETITIVE EQUITY ACT, WE CHOOSE TO CONFINE OUR COMMENTS TO ONLY TWO SECTIONS OF TITLE II -- CREDIT UNION AMENDMENTS.

SEC. 203 FAITHFUL PERFORMANCE

WE ARE IN CONCURRENCE WITH SECTION 203, WHICH WILL CHANGE THE DEFINITION OF FAITHFUL PERFORMANCE TO COVER ONLY ONE FINANCIAL OFFICER.

AS TO FAITHFUL PERFORMANCE, WE OFFER THREE (3) OBSERVATIONS:

1. FAITHFUL PERFORMANCE IS NOT REQUIRED -- OR EVEN AVAILABLE -- IN THE SURETY BOND COVERAGE MARKET FOR BANKS, SAVINGS AND LOANS OR ANY OTHER TYPE OF FINANCIAL INSTITUTION.

2. SECONDLY, IT IS, TO OUR KNOWLEDGE, WRITTEN BY ONLY ONE INSURANCE COMPANY -- CUMIS (CREDIT UNION MUTUAL INSURANCE SOCIETY).

3. FINALLY, THE COST OF THIS COVERAGE INCREASED SOME 30% DURING 1983; AND THERE ARE INDICATIONS THAT ADDITIONAL INCREASES ARE IMMINENT. SUCH INCREASES WILL SOON MAKE THE COST OF THE FAITHFUL PERFORMANCE RIDER EXCEED ITS BENEFITS, IF IT HAS NOT ALREADY DONE SO.

WE THEREFORE SUPPORT THIS CHANGE IN FEDERAL LAW AS BEING ONE THAT WILL EITHER BRING BONDING REQUIREMENTS CLOSER TO THOSE OF OTHER

FEDERAL INSTITUTIONS OR THAT WILL REDUCE THE SCOPE -- AND, HOPEFULLY, THE COST OF THIS REQUIREMENT, OR PERHAPS BOTH.

SEC. 207 CHANGE IN INSURANCE STATUS

WE ARE IN FAVOR OF SECTION 207, WHICH SEEKS TO RELAX THE REQUIREMENTS TO ALLOW FEDERALLY-INSURED/STATE-CHARTERED CREDIT UNIONS TO CHANGE THEIR SHARE INSURANCE COVERAGE. THE PROPOSAL SEEKS TO PROVIDE FOR A CONVERSION OF INSURANCE IF THE PROPOSITION HAS BEEN APPROVED BY A MAJORITY OF ALL THE DIRECTORS OF THE CREDIT UNION AND BY AFFIRMATIVE VOTE OF A MAJORITY OF THE MEMBERS AT A SPECIALLY-CALLED MEMBERSHIP MEETING WHEN A QUORUM IS PRESENT.

THE PRESENT REQUIREMENTS OF AN AFFIRMATIVE VOTE OF A MAJORITY OF AT LEAST 20% OF THE ENTIRE MEMBERSHIP WERE INACTED WHEN THERE WERE NO VIABLE DEPOSIT INSURANCE OPTIONS TO THE NCUSIF. THIS HAS CERTAINLY CHANGED NOW. EQUALLY IMPORTANT, THE REQUIREMENTS ARE UNDULY RESTRICTIVE AT A TIME WHEN MANY CREDIT UNIONS HAVE LARGE AND DIVERSE MEMBERSHIPS.

THE HISTORY OF FINANCIAL INSTITUTIONS OVER THE PAST FIVE YEARS HAS BEEN TO ENTRUST MORE AND MORE OF THE DECISIONS TO THE BOARD OF DIRECTORS. STANDARD CORPORATE PROCEDURES LEAVE CERTAIN IMPORTANT MATTERS IN THE HANDS OF THE STOCKHOLDERS -- BUT ONLY THOSE WHO BOTHER TO VOTE AT DULY-CALLED, LEGAL MEETINGS. SECTION 207 REMOVES WHAT ARE NOW UNNECESSARILY HIGH BARRIERS THAT FEDERAL LAW HAS PLACED AROUND THIS MATTER, AND WILL ALLOW STATE-CHARTERED, FEDERALLY-INSURED CREDIT UNIONS TO ENTER A WORLD OF RESPONSIBLE DECISION-MAKING AND MEANINGFUL CHOICE.

THIS CONCLUDES OUR TESTIMONY FOR TODAY. I WILL BE HAPPY TO ANSWER ANY QUESTIONS WHICH YOU OR MEMBERS OF THE COMMITTEE MAY HAVE.

OPPOSE CREATION OF CONSUMER BANKS

The CHAIRMAN. Thank you very much, Mr. Burge.

Mr. Harris, you oppose creation of consumer banks and support inclusion of industrial banks in the definition of a bank in the Bank Holding Company Act.

Industrial banks are creations of State government. Certainly that is true in the State of Utah where we have 56 such companies holding over $500 million in deposits.

Why do you feel there is a necessity to treat such entities as banks? Our State insurance commissioner testified before this committee on January 16, and she certainly doesn't support that view.

Mr. HARRIS. The conference's position is that the creation of a consumer bank at the national level, particularly identifying it as a bank, tends to ratify the nonbank bank loophole problem that exists and I think we speak to this with respect to national policy.

Within the several States, dealing with the need within the several States, we encourage specific solutions that deal with the economies of the several States. We have a deep concern that the acquisition by business corporations of consumer banks would tend to dilute the very important distinction between true deposits and accounts that tend to be risk-related.

I think it's a matter of some fine tuning, but we are deeply concerned about the ultimate question of safety and soundness of such entities if established by the Congress on a national scale.

The CHAIRMAN. Well, you indicate that a majority of the States support the position you have outlined today. What about the States that do permit industrial banks, like Utah? I've already said Utah does not support that position. What about the others that do have industrial banks?

Mr. HARRIS. Well, we certainly recognize with enthusiasm the right for individual States to enact responses for the need for financial services within the several States.

The CHAIRMAN. But wouldn't your solution make bank holding companies out of every industrial bank in my State?

Mr. HARRIS. Well, I honestly do not think so, Mr. Chairman. Those are the kinds of fine-tuning solutions that have to be worked out. We certainly believe that the holding of such an entity by a holding company should not result in such a holding company becoming a bank holding company. That is something that needs to be very seriously guarded against and it ought to be up to the option of the individual States for such a definition.

The CHAIRMAN. Well, I agree and it appeared to me that your solution would do just the opposite. It would force all of my industrial banks to become holding companies.

Mr. HARRIS. Well, if I gave that impression, that certainly was not my intent.

PLACING INSTITUTIONS CHARTERED AND INSURED BY STATES UNDER FEDERAL JURISDICTION

The CHAIRMAN. You also support the inclusion of all institutions eligible for FDIC insurance in the definition of a bank. Why would States advocate placing institutions chartered and insured by

States under Federal jurisdiction just because they are eligible for FDIC insurance?

Mr. HARRIS. Well, the system of insurance that has grown up since the creation of the FDIC has resulted in a remarkable degree of success in protecting deposits. It works. We do not intend to waver in our support of the definition of a bank to include entities eligible for FDIC insurance. In fact, that's the very thrust of what we embrace when we accept eligibility as a test. Eligibility does not exclude the opportunity for States to provide an equally safe and sound alternative. Rather than limit it just to FDIC-insured institutions, we embrace the principle of eligibility to be so insured but not necessarily required to be FDIC insured. That's the point that I intended to make.

The CHAIRMAN. Do the States that do have large private deposit insurance funds such as Massachusetts, North Carolina, and Ohio and so on, do they support your position?

Mr. HARRIS. The banking commissioners within those States, I believe, strongly support the position of the conference. Those States are outstanding examples of an effective State alternative to FDIC insurance. I speak with not absolute factual response to those specific States, but we do know that each of those three States that you referred to, Mr. Chairman, are active participants in the conference. I cannot, with candor, say specifically those three bank regulators support the conference's position, but I know they are very active participants in the conference and so I can reasonably conclude that they do not object.

The CHAIRMAN. Mr. Wagner, you support payment of interest on reserves and expansion of bank asset powers. What about payment of interest on checking?

Mr. WAGNER. Yes, sir. We would certainly support that. We feel that that's necessary to put the banks in a competitive position with other financial institutions today and we would certainly support that position.

The CHAIRMAN. What do you feel would be the effect if that provision or that privilege was granted to your member institutions?

Mr. WAGNER. Well, I think it would certainly make them more competitive in the marketplace with commercial banks today. I'm sure that as a State regulator who regulates both banks and savings and loans in Louisiana, I could probably attest to the fact that the banking community would not support that for the savings and loan industry or the thrifts, although I think in the deregulatory climate that we are enjoying today I believe that this is necessary to provide the thrifts with an opportunity to compete in that area.

I think it gets back to the—I hate to keep using the words "level playing field," because I think we've beat this terminology to death, but maybe turnabout is fair play in this case, and I think it's an important factor for the thrifts to enjoy this.

BANK UNDERWRITING AND BROKERAGE OF INSURANCE PRODUCE NO BENEFITS

The CHAIRMAN. Mr. Foudree, you indicate that bank underwriting and brokerage of insurance will not produce consumer or competitive benefits. Is there a difference between underwriting and brokerage insofar as competitive related issues are concerned?

Mr. FOUDREE. Well, we see a considerable difference between brokering and underwriting. I'm not sure I understand your question exactly.

The CHAIRMAN. Well, I'm just asking you what differences do you see because there are proposals being made to allow either or both.

Mr. FOUDREE. Certainly. Underwriting involves a whole different level of expertise. Underwriting is actually attempting to define the risks, assess the risks, and charge the price accordingly. Underwriting involves management of institutions or companies, making decisions about where to market and how much to charge and so forth. There will be some marketing decisions, but marketing is a separate process apart from the actual underwriting process itself. What we do as State insurance regulators falls into two separate categories. One is to regulate for financial solvency and the second is to regulate for market conduct of companies and their agents in the marketplace.

Underwriting involves that first regulatory area. That is, we monitor the financial condition of insurers and part of that process of monitoring is to review the underwriting decisions of insurers to make sure that, for example, they have priced their product so that it's not excessive, or not inadequate, or not unfairly discriminatory.

The regulatory area of market conduct involves supervising the marketing or production aspects of the business, looking at the conduct of agents when they actually meet with the consumers, looking at, for example, the representations that are made, looking at the policy forms and the way they are designed, whether they're readable and so forth.

So these involve two entirely separate areas of regulation and concern to us.

The CHAIRMAN. Do you believe that bank involvement in insurance is always wrong?

Mr. FOUDREE. No. I don't think we've taken that position. What we are saying is that presently we are not persuaded that banks should be permitted to get into insurance at all until we've had a chance to study this area more carefully. We think that the protections which were put in place several years ago under the Glass-Steagall Act and which are evidenced in the Bank Holding Company Act ought not to be tossed out too quickly because we are concerned that if that happens that this will have a major or a profound impact on the solvency of these institutions, or could have, and also on the ability of regulators to monitor that financial condition.

So we're not saying that banks always ought to be out of insurance and we're not trying to be obstructionists. We're simply saying let's take a very careful look at this. We know that there are practices which are occurring right now in the marketplace. There are incredible pressures being brought to bear which we do not like and we are concerned that by doing away with the safeguards which we now have in place we will simply accelerate those practices.

The CHAIRMAN. Well, does it follow then that you think insurance companies ought to stay out of the banking business?

Mr. FOUDREE. That is our statement to this committee, that we are looking at the interest of insurers of entering into the banking area. We think that the argument cuts both ways. The impact on solvency and soundness could be the same, and so we are looking—in fact right now, not only at the possibility of banks getting into insurance, but we are studying the current controls and modes of regulation which we have to deal with possible increased entrance of insurers into banking.

The CHAIRMAN. Do you think Prudential ought to get rid of Bache?

COMBINATIONS UNDER ONE ROOF CAUSE FOR CONCERN

Mr. FOUDREE. I think there are combinations that are occurring right now that do give us a great deal of concern, combinations of both securities, insurance, and banking areas, and as we've said before, the combination of those risks under one roof and the combination of the features of those three products into single products does create a great deal of concern to us. We are looking at them.

The CHAIRMAN. Why isn't it possible for people to be as direct? They were in the Utah hearings, the insurance people. They just flat out said, "Yes." You can't have it both ways. You can't say keep these other people out of the insurance business but let the insurance business and the securities business get into everybody else's business. So it follows, should Sears get rid of their S&L's? Should they get rid of their insurance company? Should American Express get rid of Shearson and so on? That's the only reason I'm leading you down this path with these questions. I understand where you're coming from and I wish it were a simpler world and those who think the legislation is driving the changes, it is not; it is the marketplace. I'm trying to get national policy decision, whatever that ends up, to try and rationalize what is going on out there. But I have to stress over and over again before I started this process several years ago, that to be consistent, if you say banks, S&L's, and so on shouldn't be in the insurance business, then you've got to say these other people can't keep making 4-A's too. That is not my position. It isn't mine that we should move backward and have divestiture and do all of that. It's politically impossible. But I think, gentlemen, to be consistent, you can't just take one side of the coin and I was pleased in the Salt Lake hearings the insurance people testifying said unequivocably yes, both ways, but the securities people did not. I did not get that kind of answer out of them. They were there with the usual testimony, don't let the banks do anything, safety and soundness, always the big straw man, but I couldn't get an answer out of them that it was not wrong for Merrill Lynch and all the others to have the CMA's and transaction accounts, no reserves, no geographical restrictions. That's what this is all about, trying somehow to rationalize what is going on in the marketplace, and you can't have it both ways. You really can't. There's got to be some distinctions made, some definitions decided upon by this Congress, and if everybody wants to mind their own business we wouldn't even have to be here. If the securities firm wanted to be a securities firm and banks wanted to be banks and insurance companies wanted to be insurance companies, mind your own business, this whole thing wouldn't come up and we could be doing something else in the Banking Committee. But that is the real world out there, gentlemen.

Mr. FOUDREE. Senator, I didn't mean to be unclear on this point. We have supported the moratorium in our previous testimony and in fact I will say that we are opposed to an insurer being part of a bank holding company system, whatever that may mean. I mean, as far as both sides, banks entering into insurance or insurance entering banking.

The CHAIRMAN. What would a moratorium do for the situation? How would that solve the problem? Let's assume we just passed a 6-month or a 1-year moratorium. What would happen in that year? What would be different than attempting to make decisions now?

Mr. FOUDREE. Well, we think that the moratorium would in fact stop the actions that are done on the Federal level and give us a chance, as I mentioned, to carefully examine the impact of removing these safeguards that have been in place so many years.

The CHAIRMAN. Well, those buzz words again "carefully consider," I've heard them many times, mostly from up here. Have you ever known Congress to carefully consider anything during a moratorium?

Mr. FOUDREE. Well, I think the Congress——

MORATORIUM COULD BE USED AS A DELAY TACTIC

The CHAIRMAN. Or is it simply—not your intent--but moratorium is used as a delay tactic because they don't want to face up to the issues? That's been my practical experience in the 9 years I've been here. It's simply a matter of let's stick our heads in the sand like an ostrich and hope when we pull it out of the sand that somehow we won't have to cast votes, we won't have to make decisions, some magical process will resolve it all if we just say stop the world. That is the practical application of the moratorium.

Mr. FOUDREE. I think you're right, that there is some danger of delay here. On the other hand, looking at the other concerns and weighing the other side of the coin, I don't want to, as an insurance regulator, be faced with angry policyholders in my State and I don't think any others do, with policyholders who have suddenly had their insurance policy become invalid or their company become insolvent because of an affiliation with a bank. That's very hard to explain to them.

So I think that we're talking about people's lives and a great deal of money is at stake which affects the individuals in every State.

The CHAIRMAN. Well, that's true. Two years ago, because of differently regulated competition, you had more savings and loans on their backs in this country, more mergers in 1982 than the Federal Home Loan Bank Board handled in the entire history of the Federal Home Loan Bank Board because of unfair competition and high interest rates. So there's another side of the coin, too.

I understand what you're saying. It's hard to explain, but it's hard to explain to a small bank, or a savings and loan, or a credit union in my State that was seeing millions and millions of dollars being taken out in money market funds and taken to Chicago and New York and invested in certificates of deposits and weren't staying home any more for mortgage loans, automobile loans, consumer finance, and so on, taken out of most of the areas of this country, most of the States, and again I'm just trying to—I'm not picking on you—I'm trying to establish once again what this committee is trying to accomplish, and that's a consensus among various groups of a balancing act of how can we resolve these issues because if we continue everybody just taking their own position without some understanding of the other side of the coin, the marketplace will go on. The abberations will become greater and one of the services that States are performing is that they're not waiting and I don't think they should. I may not agree with what they do and I may not agree and I don't with the big export that you talked about in South Dakota. What South Dakota wants to do within their own State is their own business.

But nevertheless, as long as Congress delays, what you would have during a moratorium is more action by States. They'd say, "Hey, we don't want to wait. These things are happening. We're going to take action."

Once again, it probably will be the States that finally force Congress to make some decisions, whatever those decisions are. There's another very bad problem with a moratorium because those who are already inside the barn door they won't say it, but they would love a moratorium. exclude all new competition and, boy, while that moratorium is on, we'll just wrap up all the markets we can wrap up.

Of course, some would recommend divestiture. Well, that's an easy thing to recommend. Trying to force businesses, whatever kind of businesses they are, when they have invested millions if not hundreds of millions of dollars nationally, say, "We're sorry. We've decided you shouldn't have done that, even though it was legal at the time you did it, dump it." That's great protection for people, too, because there are people who just aren't insurance policyholders. I used to earn my living in the insurance business before I got into politics, so I know something about it, but there are depositors and there are stockholders and all sorts of people. And in most cases, they're all the same people. They own insurance. They've got a deposit at the bank and they own some stock, or a mutual fund, or at least a money market account, or something of that nature. So we're not differentiating from one area to another the consumer. They are all the same people out there and they're the ones that are dramatically affected by what we do.

So I understand where you're coming from. I'm just once again trying to work through a process to get some give and take so that at the end of this we are not having a wild marketplace out there going merrily along while we take no action at all.

Mr. Unger, do you support the essential concept of S. 2181 which is allowing different types of institutions into different types of financial services? I want to ask that as a general question because I know there are obviously specific differences, but just as a general concept.

Mr. UNGER. Yes, sir; we do, Mr. Chairman, with the caveat that there be functional regulation. If banks do securities, securities regulators should regulate that aspect. If securities firms get into the insurance business, and they are and vice versa, the insurance regulators should regulate that aspect of their business.

REGULATION BY FUNCTION

The CHAIRMAN. Let me just make a comment. I don't remember as I was reading through your statements which one of you mentioned it, but in any event, you said we had not addressed some of the regulatory problems in this. We have not, intentionally, because until such time as we decide who's going to do what—in other words, what powers and authorities are available—I don't know how you decide who is going to regulate. Although I think most of you know and have probably heard me say that I do think the way to go is regulation by function, if you're in the securities business you ought to be regulated the same and not have different rules for the same type of product, but I just wanted to make the point—whichever one of you said that in your testimony—that that is deliberate. I don't know how we could possibly handle in the same omnibus bill trying to decide who does what and how to regulate it.

So we've got to make those decisions first, even though the Vice President's report is out. I see no reason to consider it seriously or act in the regulatory process until such time as we have made some decisions on powers. I would assume all of you would agree with that, that we need to keep the horse before the cart? Is there any disagreement on that?

Mr. UNGER. Mr. Chairman, I would add that while Mr. Harris stressed the strength and competitiveness of the banking industry, the same holds true for the securities industry, and the present regulatory structure of Federal and State regulation has served this country very well in promoting the capital formation needs and investor protection needs of this country. And I believe the committee and Congress, in taking a look at that structure, hopefully will evaluate that the dual regulatory structure in this country has worked very well. We have competition in those areas, and rather than undo the existing dual regulatory structure, Congress should try to plug in the legislation to deal with the changes taking place. I think your observation that the marketplace is driving Congress right now is very true and it is very important for Congress to act very quickly before you have a massive hodgepodge of products and entities engaging in all kinds of things and nobody having any control or understanding of it.

I think it's equally and perhaps most important for Congress to be very, very careful about the potential long-term problems about concentration. Several of us here on this panel come from major States and maybe concentration might be good for us, but if you have an entrepreneur in a smaller State who does not have access to capital that he may need, whether it be from an investment banker from the securities industry or a traditional bank, there could be problems and that will not serve this country well.

The CHAIRMAN. Let me say that most everybody who testifies worries about concentration, but the testimony over the last 2 or 3 years always seems to be directed somehow at concentration of banks. We always hear, do you want Chase, Citicorp, and Bank America running the country?

I am concerned about concentrations across the board. There are a lot of big other types of financial institutions in this country, securities companies, very large insurance companies, and so on. So I think we need to apply that fear across the board and worry about concentrations in general and not specifically to any one industry. That's why, whether it's an imperfect formula or not, talking about the largest 25 in S. 2181 trying to limit their participation and their expansion, that doesn't say 25 largest banks. It talks about 25 largest financial institutions. Yet I constantly hear it come back, well, you're going to just limit the 25 largest banks. That is not the intent. The intent of this committee and the concern is concentrations in any facet of the financial services industry, not just the one part of it.

CONSEQUENCES OF FAILURE TO FORMULATE A NATIONAL POLICY

Mr. Burge, if Congress fails to formulate any national policy this year, what do you foresee as the consequences of failure to act?

Mr. BURGE. As it relates to credit unions, sir?

The CHAIRMAN. As it relates to the whole industry, not just to credit unions.

Mr. BURGE. Well, as I testified, we strongly support the capitalization of the NCSIF. I feel like you're going to have to take the actions and you're going to have to move forward because as we have all talked on this panel, we all have different problems and we all have different industries that we are trying to supervise, and we are all trying to regulate them. They are all trying to get into everybody else's business and I think we are trying to say that I want my cake and eat it too, and I think not to go forward and address that will cause ultimately the citizens of this country some severe problems down the road.

The CHAIRMAN. The reason I specifically asked you that question is I know the credit unions' position is much more limited than some other organizations on this bill and I understand your position fully, and that's why I thought you might have a more outside viewpoint of the whole hodgepodge that was going on. But I do feel very strongly—and it has been the feeling of all of the witnesses we have had so far, even though there have been considerable differences of opinion on the specifics, there has been general agreement that we do need to move ahead and set a national policy.

I assume that all of you would agree with that, again still allowing for all your individual differences of opinon on specifics in the legislation, but we ought to go ahead and try to formulate that policy as soon as possible.

Mr. HARRIS. Absolutely.

Mr. WAGNER. Yes.

Mr. FOUDREE. Certainly.

Mr. UNGER. Yes.

Mr. BURGE. Yes.

The **Chairman**. Gentlemen, I don't have any more questions for you this morning. We will probably have some additional questions for your response in writing, particularly from other members of the committee. But I do appreciate your willingness to testify very much. Thank you.

I have a statement here from New York State Senator John Dunne who wishes it included in the record and, by unanimous consent, we will include his statement in the hearing record today.

[Statement of John R. Dunne follows:]

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Brookfield, Wisconsin [illegible]
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Executive Director: Charles D. Davis

news release

For release: IMMEDIATE - February 29, 1984

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COIL OPPOSES GARN BILL

Washington, D.C., February 29, 1984 -- Weighing the risks involved in financial service, against the public interest in maintaining solvent institutions, the Conference of Insurance Legislators (COIL) today informed the U.S. Senate Banking Committee that it opposes Senator Garn's bill S.2181 which would permit insurers, banks, securities houses and real estate firms to get into each others businesses.

COIL's statement was filed by New York Senator John R. Dunne former president of the Conference and author of its report entitled "Risk, Reality, and Reason in the Deregulation of Financial Services" at a hearing by the Committee in the Dirksen Office Building here.

Senator Dunne said the statement reflected the "unanimous resolve of the COIL Executive Committee." He said "It is the reality of risk, weighed against the public interest in the solvency of our financial institutions which is the main basis for COIL's opposition."

The Senator also said members of Congress and state legislatures must exercise their responsibilities when it comes to financial services regulation. "It will serve us all well to remember that it is the nest eggs of our constituents which may be broken if we let deregulation move too far at too fast a pace," he said.

A copy of Senator Dunne's statement is attached.

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Statement of New York State
Senator John R. Dunne *
on behalf of the
Conference of Insurance Legislators
filed at a public hearing of the
U.S. Senate Banking, Housing and Urban Affairs Committee
Dirksen Senate Office Building
Washington, D.C.
February 29, 1984

This statement is filed on behalf of the Conference of Insurance Legislators (COIL), a national organization of state legislators whose principal legislative responsibility and expertise is in insurance and its regulation by the several states, and reflects the unanimous resolve of the COIL Executive Committee which at its meeting in Dallas, February 17, instructed that the statement be filed with your committee.

After much study and deliberation, COIL is opposed to S.2181.

It is the reality of risk, weighed against the public interest in the solvency of our financial institutions which is the main basis for COIL's opposition.

COIL has made this judgement on grounds that

-- the risks which pervade each of the four major financial services industries and financial transactions generally are many and varied and are of such profoundly different natures that their combination in a single financial entity could threaten the solvency of the institution;

* Senator Dunne is past president of COIL and co-chairman of the COIL/National Association of Insurance Commissioners Joint Liaison Committee. He is author of "Risk, Reality and Reason, in Deregulation of Financial Services," which was published by the Conference late last year.

-- no one of the financial industries has managed its own risks well enough to justify the expansion contemplated by the proposed legislation; and

-- any such expansion could compound risks and increase dangers of financial loss to consumers and commercial buyers and users of financial services

COIL also opposes S.2181 because it could lead to

-- unprecedented concentrations of power in this country, with large money managers able to take inappropriate advantage of their customers; and

-- a diminution of the underwriting and other commercial disciplines which financial services impose on themselves, each other and their customers.

In this statement, I would like to (1) address the importance of the work done by the Senate Banking, Housing and Urban Affairs Committee, the Congress, and state legislators in regard to financial services deregulation; and (2) state COIL's specific objections to S.2181 because of what it does as well as what it fails to do.

THE EXERCISE OF LEGISLATIVE RESPONSIBILITY

COIL applauds the leadership effort being made by the members of this committee in trying to formulate national public policy in the area of financial services deregulation. As elected representatives of the people, the members of Congress and of the state legislatures have a responsibility to exercise their prerogatives as initiators of public policy in the regulation of banking, insurance and other financial services. And in this exercise, it will serve us all well to remember that it is the nest eggs of our constituents which may get broken if we let deregulation move too far at too fast a pace.

COIL has made the merging of financial institutions and products the main item of consideration ever since its annual meeting in late 1982, when, after a three day program devoted to legislative issues in financial services deregulation, it established a Task Force on Regulatory Initiative and directed the Task Force's specific attention to financial services deregulation. The Task Force was not charged with addressing the substantive question of whether and to what degree the different financial services should be permitted to mix and match their companies and products. But in a report issued by the Task Force in September, 1983 entitled: "Risk, Reality and Reason in Financial Services Deregulation," it made specific findings and recommendations relevant to S.2181, and I will discuss them later in this statement.

I. COIL OBJECTIONS TO WHAT S.2181 DOES

First let me discuss the bill and the reasons for CCIL's objections.

S.2181 would allow institutions which provide the four principal financial services -- banking, insurance, securities and real estate -- to invest and take risks in each others activities, thereby tearing down the many longstanding barriers which, in the half century since the Great Depression, have kept each essentially in its own market and area of expertise.

A. Technology Changes, but Risks Remain the Same

Much of the argument in support of the changes embodied in S.2181 focus on advancing technology. There is a great deal of reality in this. There have, indeed, been great forward leaps in computer and telecommunications technology, which have facilitated the marketing, use, and accounting of hybrid financial products and multi-tiered corporate arrangements. It is now possible to identify assets within complex holding company and conglomerate structures and transfer them in a split second, to bank from home, and to capture interest and dividends right to the last decimal, day by day.

But, on the substance, what has really changed? Beyond the display screens, crunched numbers and instant analysis, all the changes are only technical.

In all the volumes written thus far about the impact of these changes, who has dared say that their use by the different financial services has reduced one pennyweight of risk, and it is risk which gives all financial activity the traction that makes it work? Risks are never pleasant to contemplate, but we had better focus on them now.

Banks accept customer deposits and loan the funds to others, making underwriting decisions that the loans will be repaid. Insurers accept premiums in exchange for their promise to reimburse losses, betting that the insured will not incur the loss. Securities houses take positions in stocks and bonds and other paper and can take heavy losses should their prices fall. Real estate people invest in and develop land and the outcome is never certain. Without such risk-taking these financial services could not pay interest, claims, dividends or profits.

At the same time, each of these financial services depends, in varying degrees, on the real safety or that which customers perceive when they turn their money over to institutions for safe keeping or profit, hopefully, but never assuredly, both.

Because risk can never be entirely eliminated the public interest demands that safety and institution solvency be a key element in regulatory decision-making when it comes to banks and insurers.

Indeed, the very purpose of insurance for the buyer is to minimize risk and, in the eyes of many, to eliminate it entirely.

The importance of safety in banking was articulated recently by one of this nation's great consumerists, former Attorney General Louis J. Lefkowitz of New York in his brilliant dissent from the report of the Temporary New York State

Commission on Banking, Insurance and Financial Services as "so essential a protection for depositors that no other factor can overcome it."

And it is this predominant public interest in safe transactions and solvent institutions which compels us to oppose the bill.

* * *

An objective look at each industry and the consequences of their merging now shows us that adoption of the bill would not be in the public interest.

Specifically COIL's objection to S.2181 are three-fold:

(1) Each of the four financial services has its own problems in regard to the safekeeping of other people's money and each industry should put its own house in order before it gets specific government authorization to strike out for different markets;

(2) Merger could well compound problems of solvency by over concentrating both risk and power;

(3) The legislation makes no attempt to improve the quality of regulation in response to the very formidable technology and resources of emerging financial institutions.

II. TROUBLE WITHIN FINANCIAL SERVICES

The "internal" troubles banks and insurance companies have been experiencing lately are relevant for their own sake. The fact is that banks and insurers, each in their own way, have not done well managing their particular kind of risk. Each in their own way has neglected its fundamental underwriting decipline. Banks rushed to make loans to developing nations and Eastern Bloc countries and to high risk energy ventures. Insurers threw aside longstanding industry dogma, cut prices for commercial insurance and were willing to accept losses on the chance of recouping them through investment income. Result: The number of 1983 bank failures and the consequent drain on the FDIC was the greatest in four decades. Some of the nation's largest insurers have incurred severe underwriting losses and are now in a negative cash flow. Such facts are hardly the basis of sound and safe expansion.

In regard to securities and real estate the results are less clear. Both industries are experiencing revival after several lean years. In each, however, the degree of risk is much better known to buyers and, while safety of investment is an important public interest consideration, it does not have the same priority it demands in regulating banks and insurers. But neither the securities nor the real estate industry has demonstrated to any degree how the public -- both the individual consumer and the commercial purchaser of financial services --

would be better served if their two, inherently risky businesses became a presence in the insurance and banking markets. However, neither has shown the superior risk-taking ability and efficient management to justify diversification into areas where the safety factor is paramount.

III. COMPOUNDING PROBLEMS

By permitting these industries to get into each other's businesses now, S.2181 could quite possibly allow them to concentrate their risk and compound their potential losses at great expense to their customers -- to your constituents and mine.

I believe it's time to ask ourselves some hard questions.

Do our constituents want legislation that could help put bank deposits in institutions where parent companies or affiliates might call on them to help cover insurance liability risks at places like Love Canal where claims have exceeded $15 billion, or Times Beach, Missouri, or Three Mile Island, or any of the thousands of factories, dwellings, and school rooms where asbestos does its deadly work?

Do your constituents and mine want legislation that would help put their insurance premiums in accounts whose caretakers might need the funds to make up for losses on loans to the Third World or Eastern Bloc countries or speculative energy ventures?

Do your constituents and mine want legislation which puts their bank deposits or the insurance premiums within easy reach of those who have sold investments in Baldwin-United SPDA's, WPPS bonds, or untenanted, unsold or half-finished buildings that, like it or not, are the end product of some real estate development ventures:

I say this with the full knowledge that S.2181 would allow the different financial services to invade each others markets and compete for each others businesses only through holding companies and subsidiaries. I know there are many who contend that by "functional regulation" there are devices intended to separate accountability and to provide for segregation of funds and continuity of regulatory surveillance and supervision. Maybe so, but someone will have to prove it. And no one has proved it yet.

Indeed, the history of holding companies past and present shows that quite the opposite can be true. And as each day brings us further evidence of the Baldwin-United tragedy of a "model" financial services conglomerate gone wrong, we see clearly how holding company arrangements can degenerate into a shell and pea game which exposes people's savings and retirement income to great risk.

Such situations can frustrate regulators and confuse the public. The recent step by Charter Company, another financial services and energy holding company, to spin-off its insurance subsidiary, Charter Life, on grounds that the consumers and investors were confused with its conglomerate structure, shows what can happen.

IV. CONCENTRATION OF POWER

COIL also has severe reservations concerning the consequence of the economic forces which S.2181 would set in motion. Legislators here in Washington and in the state capitals would have to face the possibility that people would live and do business in an entirely different and restrictive economic climate.

In Canada and in Europe where the cross-breeding of financial services has long been a fact of life a mere handful of those institutions dominate the capital and insurance markets. Insurance buyers in West Germany have only 30 insurers from which to choose coverage. In the United Kingdom there are 200 banks taking consumer deposits. In the United States today there are 5,000 insurers and more than 40,000 banks, 150 securities underwriters and over 17,000 real estate developers, supporting more than 56,000 independent brokerages, agencies, and countless market-counselling and support firms. That system is not perfect but it does yield the benefits of competition and consumer choice as to quality of product, service and price.

There is the potential that the enactment of S.2181 could severely restrict that freedom of selection. For example, mortgagees and other lenders could have tremendous leverage on borrowers who could be asked -- no matter how carefully and how "legally" -- to accept insurance coverage on a mortgaged property from an insurance firm "affiliated" with the lender. I know this is not a new argument against the merging of financial services. But I wonder whether the pervasiveness of such consequences has been considered fully. Young professionals and those training in medicine or law, to take another example, often have compelling need to borrow. They also have compelling needs for professional liability coverage and those needs will grow. The leverage of lenders on them could be most severe.

Commercial enterprises which borrow to meet short term expense and capital needs could easily be the target of aggressive moves to capture their employee benefit insurance premiums.

And let's not get confused. The leverage factor can work both ways. The buyers of insurance can easily be positioned to look to lending institutions affiliated with their insurers to handle their corporate short and long term borrowing needs.

Consider also that the separation of the different financial services provides a system of checks and balances which contributes immeasurably to their efficiency. If they use their basic underwriting skills well, these institutions effectively audit each others activity and effectively question the soundness of what their customers are doing.

Banks now put borrowers through many hoops before they loan money. Will they be as careful when they know they have a clean shot at a borrower's insurance premiums?

Insurers in many cases carefully inspect insured properties and examine customer loss experience. Will they do the same when they also have access to the insured's bank deposit? Securities underwriters are under heavy obligation to make sure the companies whose stock they underwrite have disclosed all that is pertinent to prospective investors. Will they exercise less scrutiny when they, in fact, can corner that underwritten company's bank deposits and insurance?

How much will banks scrutinize real estate development ventures when they themselves own the developer and the potential profit is dancing before them?

All these questions get to the very nature of how our great financial institutions function and serve our society. Until they are answered, enactment of S.2181 would be most premature.

V. WHAT S.2181 FAILS TO DO

In addition to the above reasons, which COIL believes get to be the very substance of S.2181, the conference has the most grave reservations concerning this legislation because it contains no appropriate regulatory responses or counter measures in the light of the changes it proposes and the real world situation which is developing in financial services today.

The fact is that today's regulatory institutions lag far behind supposedly regulated industries in human resources and technical capability.

In November, 1982, the COIL Task Force on Regulatory Initiative was given the charge "to make findings concerning the ability of state insurance departments to respond to issues and problems evolving in insurance," with its attention directed specifically at the emergence of financial supermarkets and multi-purpose financial products.

In "Risk, Reality, and Reason, in Financial Services Deregulation," the Task Force disclosed its findings that state insurance departments would not be able to do their job of watchdogging for insurer solvency unless the states make a commitment to give insurance commissioners the people and resources they need to do their jobs in this day of instant fund transfer and overnight takeover. In making its recommendations the Task Force said

> "The revolution going on in the financial services industry has been made possible by three basic elements: changing technology in data processing and telecommunications, increased capital outlay, and innovative and creative thinking. If state insurance regulators are to maintain and strengthen their traditional prerogatives and, at the same time, encourage development of a strong insurance mechanism, they will need to employ the very same elements which are being so successfully utilized by the industry they regulate."

Both COIL and the National Association of Insurance Commissioners have resolved that insurance departments get the state funding that will help bring their human and technical resources up to the state of the art of regulated industries. Thus, both the legislative and executive branches of state government are committed to make the necessary improvements that the times demand, and that will enhance the further development of an insurance regulatory system which has fostered the growth of strong competitive markets in this country. I respectfully submit that the Congress and federal executive seriously consider making a similar commitment in regard to those financial services which they regulate.

VI. RE-ALIGNMENT NOT ENOUGH

A cursory look shows how difficult it may be in this era of budget and staff cuts, for the federal regulatory establishment to monitor the banking and securities businesses.

The Vice Presidential Task Group and its call for a new alignment of the federal regulatory agencies is appropriate. But it is only a realignment.

VII. CONCLUSION

COIL believes there are many benefits that consumers and private business can realize from deregulation within each industry as long as the separate institutions exercise basic underwriting judgments and regulators, both state and federal, have what is needed to monitor for soundness and solvency.

But, for the present and at least until those appropriate regulatory responses are in place and working well, cross breeding of the major financial services would be a mistake that could cost policyholders, depositors and investors far more than they might receive in technical conveniences.

COIL, its officers and executive committee, look forward to a continued dialogue with the Congress on behalf of our shared constituents.

Thank you.

[Response to written questions from Senator Garn follows:]

NAIC
EST 1871
NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS
1125 Grand Avenue Kansas City, Missouri 64106 (816) 842-3600

April 13, 1984

BY HAND

Mr. Jake Garn
Chairman
Committee on Banking, Housing
and Urban Affairs
United States Senate
Washington, D.C. 20510

Dear Chairman Garn:

This is in response to your letter of April 5 in which you pose the following question relative to my recent testimony before your committee:

> "You raise the fear that tie-ins will result if bank holding company affiliates are allowed to sell insurance. Yet some states permit their banks to sell insurance. Shouldn't it be desirable for banks to sell insurance, if state chartered banks are allowed to do so?"

This is precisely the issue which the NAIC is now studying. Existing state insurance laws relating to debtor coercion are themselves a product of previous NAIC studies. Past marketing practices, coupled with significant federal and state interest in protecting the solvency of financial institutions generally, are the basis for our current inquiry. While we raise the possibility of harm, we are interested in the actual impact of expanding the marketing ability of banks.

At the present time, it is not possible to know with certainty what that impact will be without further study. Therefore, before we conclude that all banks should be allowed to market insurance, we should carefully examine the actual experience of those state banks which have historically done so.

Sincerely,

Bruce W Foudree

Bruce W. Foudree
Chairman, NAIC Integrated
Financial Services Task Force

cc: JC/EM/DB/file

North American Securities Administrators Association, Inc.

April 12, 1984

The Honorable Jake Garn
United State Senate
Committee on Banking, Housing
  and Urban Affairs
Washington, D.C. 20510

Dear Senator Garn:

Thank you for your letter of April 5, 1984 concerning the testimony which I gave on behalf of the North American Securities Administrators Association (NASAA) on February 29, 1984 before your Committee. In your letter, you requested that I respond to several questions concerning S. 2181 and S. 2134, so that those responses may be included in the record of the hearing.

Since you have requested that my responses be submitted to you by April 13, 1984, it is not possible for me to have submitted the responses for comment and concurrence by Michael Unger, President of NASAA, whom I accompanied to the hearing on February 29, 1984. While I believe that these responses are consistent with his own thinking, please be advised that these responses are my own and do not necessarily represent the official position of NASAA or the position of its President.

The first question raised by you relates to our recommendation that consideration be given to prohibiting mutual fund purchases of securities of a company which is a substantial borrower of the sponsoring bank. I believe that this is a specific potential problem, not only a problem that arises any time the investment banking and corporate banking functions are combined. The reason is that in sponsoring the mutual fund, the magnitude and continuity of the financial relationship of the sponsoring bank and the mutual fund is of a far higher order of magnitude than exists when an

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investment banker underwrites a specific public offering or renders advice to its issuer-client with regard to a particular transaction. The sponsoring bank of a mutual fund is bound to a long-term contractual relationship which does not exist with respect to the relationship between an investment banker and its client. Experience has told us that the relationship between a mutual fund sponsor and the mutual fund itself is one which is rarely, if ever, broken, whereas the relationship between an investment banking firm and its client can sometime be long-term and continuous but on many occasions can be restricted to a single event and a switch by a client from one investment banking firm to another is a frequent occurrence. Even if the relationship between the sponsoring bank and the mutual fund is deemed to be equivalent to the relationship between a securities firm which underwrites corporate offerings and at the same time advises its clients to buy securities in that offering, the latter being a relationship which is a condoned under the Securities Act of 1933 and the Securities Exchange Act of 1934, the magnitude of the potential conflict must be measured in the context of those sections of the Investment Company Act which, under the proposed legislation, are intended to be retained as restrictions applicable to the mutual fund and its investment banking firm sponsor. Given the apparent intention to retain the existing restrictions applicable to investment banking sponsors, I believe it would be unfair to impose substantially less restrictive provisions applicable to sponsors which are banking institutions.

The next question posed by you deals with whether NASAA believes that banks should be permitted to offer mutual funds, act as securities brokers and underwrite municipal revenue bonds. NASAA has serious concerns regarding whether these activities will result in banks assuming additional risks which will not be to the benefit of their deposit holders. However, NASAA also believes that the evaluation of the seriousness and magnitude of this risk is better left to the assessment of bank regulators and others, and we therefore defer to their judgment on this issue. From the viewpoint of securities regulators, we have no objection in principal to banks being permitted to offer mutual funds, act as securities brokers and underwrite municipal revenue bonds. In connection with the offering mutual funds, we have heretofore commented to the Committee in my testimony regarding additional protections against conflict of interest. With regard to securities brokerage activity of banks, we have endorsed your bill's concept of placing those activities in an affiliate of the bank holding company, or in the bank holding company itself, although in my testimony we propose additional coverage of that concept in order to avoid a potential gap. Our reason for endorsing the affiliate concept is grounded in the fact that this will enable those brokerage activities to be under the supervision of appropriate securities regulators. The use of an affiliate structure will also tend to reduce the risk of the banking institution itself from losses resulting from any such brokerage activity.

I trust that the foregoing is responsive to your questions. If further information is desired, please don't hesitate to contact me.

Very truly yours,

FRANKLIN TOM
Chairman
Financial Institutions Committee

FT:ad

cc: Mr. Michael Unger
Members of the NASAA Financial Institutions Committee
Mr. Bruce Burditt
Ms. Maureen Thompson

NATIONAL ASSOCIATION OF STATE CREDIT UNION SUPERVISORS
NASCUS

[illegible] CHAIN BRIDGE ROAD, SUITE 201 • McLEAN, VIRGINIA 22101 • (703) 821-2243

May 3, 1984

The Honorable Senator Jake Garn
Chairman, Senate Banking Committee
SD-534 Dirksen Senate Office Building
Washington, D.C. 20510

Dear Senator Garn:

We are pleased to present the following responses to your questions.

1) To what extent have credit unions used state-insured funds such as in your state of Georgia?

At the end of 1982, 98.4% of all credit unions in the United States were insured under either federal or state programs. This accounted for 99.3% of total credit union savings.

Out of the total of 8,476 state-chartered credit unions, with 38 billion in savings, 36% of all state credit union assets, or $14 billion were insured by 17 state plans. The remaining 63% were insured by the National Credit Union Share Insurance Fund (NCUSIF) representing $24 billion in assets.

2) What has been the experience of your state's fund (its health and claims against it)?

The Georgia Deposit Insurance Corporation (GDIC) has had an excellent history of financial growth and financial health.

Market Penetration

Incorporated in 1974 and operating since January 1, 1975, GDIC presently insures 128 of our 167 Georgia state-chartered credit unions for a total of $720 million of insured assets. GDIC also insures three state-chartered savings and loans with total insured assets of $60 million.

Financial Condition

At year-end 1983, the GDIC corporate entity showed $4,850,000 in assets, $128,000 in liabilities and an equity account with $2,110,000 in membership fees and $2,613,000 in the reserve fund. We consider it to be in excellent financial shape.

Claim History

In its nine-year history, GDIC has expended $293,400 in claims, and recovered $261,000 for a net loss of $32,400. Over that same period, GDIC collected $2,550,000 in premiums. The $32,400 net loss figure represents 1.2% of premiums collected. We consider this to be an excellent loss history.

3) What oversight do you have over the fund and what oversight do other state supervisors have over such funds in states which authorize state or private insurance coverage?

The GDIC was created by the Georgia Legislature and was set up as a state-chartered financial institution subject to our jurisdiction. We have a very close-working relationship with GDIC. The law requires an annual CPA audit, which we may accept in lieu of our own outside examination.

With regard to oversight by other states, we have reprinted from the 1984 Comparative Digest of Credit Union Acts published by Credit Union National Association (CUNA) each state and the governmental agency which oversees the share insurance corporation.

> "SHARE INSURANCE CORPORATION SUPERVISED BY authority specified and annual examination required:
>
> California -- Commissioner of Corporations. [§16151]
>
> Connecticut -- Commissioner of Banking. [§7(b)]
>
> Missouri -- Director of the Division of Credit Unions of the Dept. of Consumer Affairs, Regulation and Licensing. [§370.375]
>
> Nebraska -- Department of Banking. [§27-17,140]
>
> North Carolina -- Commissioner of Insurance. [§54-44-1]
>
> Tennessee -- Commissioner of Banking. [§45-4-1111]
>
> Texas -- Commissioner of Credit Unions. [§11.10(e)]
>
> Virginia -- State Corporation Commission. [§6.1-226.10(1)]
>
> Washington -- State Supervisor of the Division of Savings & Loans. [§31.12A.120]
>
> Wisconsin -- Commissioner of Credit Unions. [§186.35(7)]

BYLAWS SUBJECT TO APPROVAL of Commissioner of Banks. Other powers which corporation may exercise subject to approval or rule-making authority of commissioner:

Massachusetts [Ch. 294,§3,6]

New Mexico [§58-12-4,12-10]

OTHER ACTS:

Florida -- The books, records and accounts of the corporation shall be subject to an examination by the Department of Banking and Finance. [§657.263]

Kansas -- Records of guarantee corporations open to examination and investigation by the Administrator of Credit Unions, who may also adopt rules and regulations to implement law. [§17-2257,2260]

Maryland -- The Banking Commissioner must approve bylaws, rules and regulations set by the corporation. [§7-104(A)]

New York -- The credit union insurance fund may be organized with the approval of the superintendent of banks. [§481]

Ohio -- The superintendent of credit unions is empowered to issue, amend, and rescind such rules and orders necessary to further the purposes of the act and to protect the guaranty association, the member credit unions, or the public interest. He shall make or cause to be made an annual examination and such special examinations as he deems necessary. [§1761.31]

Puerto Rico -- The Shares and Deposits Insurance Program is established in the Office of the Inspector of Cooperatives of Puerto Rico, under his supervision and management. [§76-1151K]

Rhode Island -- The corporation is subject to supervision by the director of business regulation, who shall examine the books, assets and liabilities of the corporation at least every 2 years. [L. 1976, H.B. 7401, §11]

ACT IS SILENT:

28 states"

I you have any other questions, we have included a copy of the 1983 Yearbook of State Share Insurance, published by the International Share & Deposit Guaranty

Association (IS&DGA) and CUNA, and a copy of the 1984 Comparative Digest of Credit Union Acts, published by CUNA.

Thank you for the opportunity to provide these answers.

Yours truly,

Charles Burge

Charles W. Burge
President, NASCUS
Deputy Commissioner of Thrift
Institutions, Georgia

CWB/sjo

Enclosures: 1984 Comparative Digest
1983 Yearbook of State Share Insurance

Information included in responses 1 through 3 was obtained in part from the 1983 yearbook of State Share Insurance published by the International Share and Deposit Guaranty Association and the 1984 Comparative Digest of Credit Union Acts published by Credit Union National Association.

The above mentioned publications are available by writing to:

International Share and Deposit Association
2990 Brandywine Road
Atlanta, GA., 30341

National Association of State Credit Union Supervisors
1499 Chain Bridge Road
McLean, VA. 22101

National Association of
State Savings & Loan Supervisors

1001 CONNECTICUT AVENUE, N.W., SUITE 800, WASHINGTON, D.C. 20036 • (202) 452-1523

May 3, 1984

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The Honorable Jake Garn
Chairman
Committee on Banking, Housing and
Urban Affairs
534 Dirksen Senate Office Building
First and C Streets, N.E.
Washington, D.C.

Dear Senator Garn:

Pursuant to your letter of April 5, 1984 to Mr. Hunter O. Wagner, Jr., we would like to provide you with the National Association of State Savings & Loan Supervisors' response to the questions you posed concerning S. 2181 and S. 2134. Our response follows each question.

1. What is "asset risk" in your mind and how do we deal with it as the system changes?

The investment and lending authority or asset powers enjoyed by state-chartered savings institutions for a century were restricted in most states to home mortgages and a limited amount of other real estate-related activity.

Since the original path of deregulation did not include a route for the nation's housing lenders, rate-controlled savings institutions were losing the deposits with which they funded long-term, low interest housing loans. Congress and some legislatures responded by eliminating rate ceilings, which allowed savings institutions to recapture lost deposits, although rates were as high as 16%. Savings institutions were thus paying as much as 16% to fund old long-term home loans often yielding less than 5%. And new mortgages could not be made, due to public inability and unwillingness to borrow at rates above the institution's cost of money. Consumers bought a few cars at 13% to 20%, but no houses.

The appropriate and necessary response to the pressures of deregulation initially by some state legislatures was to expand their savings institution's asset powers, that is to permit the imperiled housing lenders to invest some small portion of total assets in higher return investment vehicles. Return is determined by risk, of which there are two types: rate risk and credit risk. Rate risk was not a factor when national and global economies were stable and cost of funds was controlled. For most of the preceding 100 years rate risk was not a factor. Credit risk was the important risk factor. Home lending carried very little credit risk. Risk was low, therefore, return was low, so low as to be unattractice to private owners, resulting in a history of mutually owned, essentially nonprofit home lending institutions. The responsive congressional and legislative decisions to permit savings institutions to spread their rate risk to other investments and use a portion of their assets to seek higher returns necessarily permitted higher credit risk.

In the newly competitive financial institutions marketplace it is inappropriate to remove new asset authorities upon which the housing lenders must now depend for new funds and for profitable interest spreads in mortgage lending. If forced to compete without the new asset authorities, the fate of savings institutions would be questionable because credit risk would be reduced and low-return mortgage funds would dry up, stolen by higher paying commercial borrowers.

There are several ways in which we may deal with asset risk as the system changes. First, regulators must control allowable risk. State and federal regulators must develop more sophisticated monitoring systems to (1) yield more reliable financial data; (2) better interpret such data; and (3) move more quickly to take enforcement action in cases of noncompliance with regulations affecting safety and soundness. Second, depositors must accept some responsibility for the selection of depository, which may vary dramatically in operational safety and capital soundness from institution to institution. Regulatory authorities are a buffer against failure, but are without the capacity to guarantee against such failure. Third, insurers of accounts, both state and federal, must adjust their underwriting standards and premium schedules to the reality of increased risk. Insurers of accounts, whether FSLIC, FDIC or private state funds, must exercise care over who they insure, set premiums to maintain reserves that adequately reflect risk, and monitor performance for changes in risk.

2. Should institutions engaged in "banking" and involved in the "payments system" be considered "banks" even if they are only "eligible" for FDIC insurance?

Non-regulated financial institutions and other unregulated entities using names that misrepresent their character must be brought into a regulatory framework. We are troubled by manipulations of terminology that attempt to divert reasoned inquiry by the Congress from the actual issues at hand. The true issue is the "loophole" which permits the existence of non-regulated or under-regulated financial institutions which trade on public confidence carefully established over decades by traditional commercial banks and thrift institutions. The focus on FDIC insurance "eligibility" and participations in the payments system misses the fundamental question: What is the nature and character of the institution in question?

Savings institutions which meet the 60% qualifying asset test are not in the nature of commercial banks. Their nearly exclusive real estate focus requires -- and has been well served by -- a separate regulatory apparatus. Despite the effects of deregulation, savings institutions' asset quality will remain stronger than commercial banks and necessary reserves will remain lower. A separate regulatory structure for savings institutions will continue to be appropriate.

We cannot resolve the dilemma posed by new forms of financial institutions. The National Association of State Savings & Loan Supervisors believes that those savings and loan associations which are of such a fundamentally different character and are such an insignificant portion of the nation's total depository and "payments" structure that they should be exempt from the definition of "bank" for purposes of the Bank Holding Company Act of 1956, as amended.

We trust this has been responsive to your inquiry.

Very truly yours,

Sheryl Jones Alu

Sheryl Jones Alu
Associate General Counsel

SJA:sek

The Chairman. May we have you attention please so we can continue with the next panel. We are pleased to have before us another distinguished panel composed of Glenn Nishimura, legislative representative, Consumer Federation of America; James M. Hacking, assistant legislative counsel for Federal legislation, American Association of Retired Persons; Gale Cincotta, executive director, National Training and Information Center; and Pauline Wilson, chairperson, Coalition Against Redlining.

Mr. Nishimura, would you like to begin?

STATEMENT OF GLENN NISHIMURA, LEGISLATIVE REPRESENTATIVE, CONSUMER FEDERATION OF AMERICA

[The complete statement follows:]

Mr. Chairman and members of the Committee, I am Glenn Nishimura, Legislative Representative for Consumer Federation of America. CFA is a federation of over 200 national, state, and local consumer, senior citizen, labor, farm, cooperative and rural organizations whose combined membership totals over 30 million consumers.

CFA testified last year before this Committee on the pace and direction of deregulation occurring in the financial services industry. We are pleased to be able to follow-up that testimony with our views on S. 2181, the Financial Services Competitive Equity Act and S. 2134, the Depository Institutions Holding Company Act Amendments of 1983.

The last several years have produced substantial deregulation of financial services. The moving forces behind that deregulation have been two major pieces of legislation, technological advances, loopholes, regulatory permissiveness, and industry aggressiveness. The dust is beginning to settle and broad generalities about the impact of deregulation on consumers are becoming clear.

Most apparent is that there are and will be distinct categories of winners and losers in the deregulation process. Among those on the losers side are small businesses and homebuyers (for whom long-term fixed rate funds are getting increasingly scarce), consumer borrowers (for whom real interest rates on loans tripled in 1981 and have stayed at that level), and small depositors (for whom bank fees and service charges are on the rise). The winners are large depositors (who get a higher rate on their savings while escaping many bank fee increases), purchasers of stock (who have benefited by bank entry into discount brokerage), and those with a large portfolio of assets (who will have the convenience of doing most of their business under one roof). In the name of convenience and to the benefit of the more affluent, banking deregulation, thus far, has shifted costs onto lower and middle-income consumers.

CFA believes that, at this juncture, Congress should stop to assess what has happened and decide on how much more deregulation is desired. A "go slow" posture is preferable to one that moves ahead haphazardly under the banner of deregulation.

After all, the market is still shaking out from the effects of sweeping legislation passed in 1980 and 1982. Another jolt in 1984 seems unwise.

The wisdom of a measured approach is even more apparent in light of existing problems in the industry, problems that worry the depositing public and threaten the safety and soundness of our entire financial system. Let me comment on just four.

International Loans -- Over the past 5 years, foreign lending by U. S. banks doubled. Greater pressure to increase earnings has driven banks to speculate on foreign markets, where they can earn high fees. Foreign governments and businesses on a borrowing spree have rung up massive debts. Moderation was not preached by U. S. lenders. While CFA is concerned about the adverse effect that this has had on consumer loan rates, the more frightening prospect is the possibility of a major loan default and its ramifications on the world market. What is the next bold experiment banks will undertake with the new powers they seek? And what will be the risks there?

Bank Failures -- Major collapses such as that of Penn Square and the Butcher banks have brought the question of stability into focus. In addition, the Butcher bank debacle demonstrated the inability of federal regulators to stop insider loans, conflicts of interest and unwise business dealings, even in an industry that has not diversified. Can those regulators protect the integrity of banking if deregulation allows banks to expand to insurance, securities and real estate ?

Brokered Deposits -- Prominent bank failures created a problem with brokered funds. Money brokers would split funds into FDIC-insured $100,000 segments, then broker them to the highest bidder without concern for the stability of the borrower. Oftentimes problem banks were found to have a large, sudden influx of brokered funds. The risks of this bidding war for large chunks of money are being borne entirely by the government through the FDIC insurance mechanism. Even pro-deregulation regulators like FDIC Chairman Isaac have seen the need for regulation to stop this unintended use of federal insurance. What other areas of "deregulation" will be subsidized by taxpayers?

ARMs -- Creative financing has introduced all types of adjustable rate mortgages into the marketplace. ARMs are confusing, defy disclosure protections and place a great deal of risk on the borrower. Earlier this month, the Mortgage Guarantee Insurance Corporation (MGIC), the nation's largest mortgage insurer, announced that it would no longer underwrite ARMs that were deeply-discounted upfront, only to escalate rapidly in subsequent years. In tightening its ARM standards and credit standards, MGIC alerted us to the fact that the mortgage market was getting out of hand. Consumers lured into these deep-discount deals will be in great jeopardy of losing their homes when their mortgage interest rates shoot up, as they assuredly will. What other new instruments will be invented in a deregulated environment, and who will explore their risks and benefits?

With this record of dubious achievement, it is understandable that consumers are unsure about further banking deregulation. Much has happened over the last few years that has made the market more complex, changed the nature of credit availability, altered cost allocations, and weakened consumer protections. The legislation at issue in this hearing propose to create yet more change. Product deregulation and interstate banking raise fundamental questions about concentration, conflict of interest and safety and soundness. Because so much has happened so quickly, CFA encourages this committee to pause for further deliberations. Specifically, CFA recommends the following:

Close nonbank bank loopholes and require owners of nonbank banks to either comply with federal banking regulations or divest themselves of their acquisition. Nonbank banks that have squeezed through loopholes believe that, since they have breached banking regulations, those regulations should be altered to accommodate that breach. Not so. The fact that regulations have been circumvented is no reason to legitimize that circumvention. Congress, in due time, should approve a planned, systematic change that is designed to achieve equity and serve the public interest.

--On the issue of allowing banks to enter other fields such as insurance, CFA supports a delay in permitting such expanded activities. While we believe that the insurance industry could use a healthy dose of competition, there are legitimate concerns over excessive economic power and tying of products. In 1982, bank holding companies were given the authority to underwrite credit insurance, an area of acknowledged consumer abuse. Congress should analyze bank holding companies' performance in providing credit insurance, not only to assess possible tying activities, but also to determine whether bank entry has resulted in more competition and lower prices for consumers.

--In closing the South Dakota loophole, CFA supports the approach embodied in S. 2134. The question is not just whether a state should be able to exempt itself from financial practices it inflicts on the rest of the country. CFA finds South Dakota's actions to be unconscionable in this regard, but recognizes that the real issue is whether states should be permitted to undermine federal laws that seek to assure the safety and soundness of the financial system. We believe they should not. [The South Dakota loophole is reminiscent of banks pitting states against each other to see who could pass the weakest usury and consumer protection laws.]

--Congress should pay particular attention to strengthening the Community Reinvestment Act (CRA) to assure that deregulation does not produce disinvestment for capital-starved neighborhoods and small businesses. This could be addressed in different manners. Large depository institutions that cross state lines could be subject to comprehensive community reinvestment disclosure requirements, including disclosure of small business lending. Depository institution performance in complying with CRA goals and supporting local small businesses could be used as a yardstick in deciding on whether to permit future expansion. CRA standards could be extended to include other market participants or a new mechanism to provide investment funds to communities could be devised.

--Consumer protections and disclosures should be meaningful and accurate. Truth-in-Lending revisions are needed to make sense out of new market instruments. In addition, Congress should enact Truth-in-Savings legislation to allow consumers to make informed decisions in picking from a diverse array of savings options.

CFA remains unconvinced that major change in financial services should occur rapidly. The stakes are too high. Congress is justified in taking a cautious approach.

Banks _are_ special institutions. Their transactions involve other people's money. They play an intrinsic role in the conduct of monetary policy. Federal deposit insurance guarantees safety and promotes consumer confidence. Consequently, changes in the financial structure should be aimed, not merely at meeting the challenges of technological innovation, but, to assure that the system serves the public well.

We would also like to respond to three provisions included in S. 2181, but not in S. 2134, that have important consequences for consumers: preemption of state usury ceilings, consumer leasing amendments, and check hold policy disclosures.

Preemption of State Usury Ceilings

CFA remains adamantly and unalterably opposed to Title VII of S. 2181, the federal preemption of state usury ceilings. We opposed the concept in its earlier incarnation as S. 730 and believe that the provisions of this bill are even more dangerous in the setting of S. 2181. S. 730 did not progress beyond the hearing stages because it was unable to gather support on its own merits. But, as a part of an omnibus banking bill, state usury preemption may be lost among a crowd of other important issues. We urge this committee to act quickly in striking this title from S. 2181.

State usury laws are legitimate vehicles through which states protect certain parts of the population against abuse and victimization. And, the fact that almost all states have adjusted their laws in the last 3 years, brings into question the need for federal legislation. Futhermore, CFA believes that some responsibility for extraordinarily high real interest for consumers can be traced to the fact that states have been liberalizaing their usury ceilings.

Supporters of federal preemption make several assumptions: that the credit marketplace is competitive, that higher rates will allow for greater credit availability and that consumers are informed sufficiently to protect themselves. All of these assumptions deserve closer scrutiny.

While some credit markets, such as new car loans, are more competitive than others, that competitiveness should not be generalized over the entire marketplace. Where credit gouging occurs at its worst in those markets where consumers are less sophisticated. Evidence of exorbitant loan rates for used cars and second mortgages bears this out. State usury laws appropriately seek to protect these vulnerable borrowers from unscrupulous lenders.

In return for higher rates, consumers are supposed to get increased credit availability. Usury ceilings prevent the poor from getting credit, it is claimed. Following a state usury ceiling hike, a New York State Bank Commission study that tried to prove this hypothesis ended up providing evidence to support an entirely different conclusion: that, while interest rates rose to meet the higher usury ceiling, credit availability did not expand. In short, virtually the same borrowers who were getting 18 were paying 25 . In New York, higher interest rates, rather than making credit available to higher risk borrowers, resulted in only increasing the earnings of lenders.

Finally, relating to the issue of informed consumers, usury preemption is being proposed at a time when the level of consumer confusion is at an all-time high. Deregulation has led to variable rates, new fees, and the erosion of consumer disclosure laws. Consumers are less capable of operating efficiently in the financial market than ever before. Dreregulation will impact most harshly on small borrowers and the low-income, and usury preemption will most adversely affect that same population.

Title VII will erase vital protections for a vulnerable segment of the population and will not deliver on promises of more credit. It would move us away from the ideal of an informed consumer in a competitive market. We urge that it be struck from any bill reported by this committee.

Consumer Leasing

Just as we believe that the usury section would do damage to low-income consumers, CFA believes that Title V, the consumer leases and rental-purchase section of S. 2181 would harm low-income consumers, and should be deleted from this bill.

Title V is being promoted as a consumer disclosure amendment, an idea that usually finds favor with CFA members. But, a closer investigation of the issues involved reveals that consumers may be worse off if this section is adopted.

Rental-purchase agreements are mainly directed at the low-income community and others without credit. Enticed by the prospect of "no credit check," consumers enter into contracts that result in their paying a highly inflated price, for an item, estimated at 2½ times the real value.

The issue is not disclosure, it is consumer protection. Some states have ruled rental-purchase agreements to be retail installment sales. As such, these agreements fall under laws that provide consumer protection provisions on certain parts of the transaction, such as contract terms, usury limits, and repossession procedures.

On the other hand, some states have designated rental-purchase agreements as leasing arrangements, whereby consumers don't enjoy the same protections. While distracting us with the disclosure provisions of the section, supporters of Title V are really after a federal law that recognizes and thus legitimizes rental purchase agreements as leasing arrangements.

What is most ironic is that contract restrictions, usury laws, and repossession rights are elements of consumer-retail transactions that have been designed to protect the less sophisticated, more vulnerable consumers. Rental-purchase industry deals almost exlucisvely with these consumers, yet Title V would lead to stripping their customers of essential consumer protections.

For that reason, while CFA generally supports clear and meaningful disclosure, we believe the issue here is much broader and urge this committee to delete Title V.

Disclosure of Check-Holding Policies

CFA does support Title VI of S. 2181, alling for dislcosure of hold periods on checks and requiring improvements in the check-clearing process. We would support ever stronger legislation that would limit the hold periods.

Our support of the disclosure requirement is based on widespread consumer problems that have arisen from "delayed availability" of their funds. While disclosure should prompt competition in this area, CFA recognizes that such a result is unlikely. The simple reason is that banks have great incentive to hold checks as long as possible. The longer the hold, the greater the ability to boost revenues by investing held funds. If the funds happen to lie in traditional checking accounts, then the depositors are effectively making interest-free loans to the bank.

While the rest of the banking industry is besieged by high-speed, highly automated movement of money around the block and across the country, the check clearing process remains as a monument to the days before electricity. And, while some banks have responded to consumer demand for disclosure and shorter hold periods, the incentive for profit is too great to expect widespread change.

Accordingly, CFA supports Title VI as a first step toward reducing lengthy check hold periods at financial institutions.

The CHAIRMAN. Thank you, Mr. Nishimura.
Mr. Hacking.

STATEMENT OF JAMES M. HACKING, ASSISTANT LEGISLATIVE COUNSEL FOR FEDERAL LEGISLATION, AMERICAN ASSOCIATION OF RETIRED PERSONS, ACCOMPANIED BY RALPH W. BORSODI, ECONOMIC CONSULTANT

Mr. HACKING. Thank you, Mr. Chairman. On my right and accompanying me is Mr. Ralph Borsodi, who is one of our economic consultants.

We are here representing the nearly 16-million-member American Association of Retired Persons [AARP]. With the association's statement included in the record, I will try to keep my remarks as brief as possible.

AARP is a strong believer in the salutary effects the free market and competition have in containing price increases. For a decade we advocated the lifting of regulation Q. We as an association are desirous of promoting competition among those who offer financial services.

However, commercial banks and financial institutions by any other name which have the power to create deposit money against fractional reserves have very special powers given to them by the State and Federal authorities. Because of this, the State and the Federal Government have seen fit in the past to circumscribe the activities of banks. It is now said that advances in computer technology and communications dictate that commercial banks should be free to engage in various commercial and financial activities from which they have been in the past prohibited.

COMPUTER TECHNOLOGY RAISING MORE SAFETY ISSUES THAN SOLVING

We can understand how technology is breaking down geographical limitations on business activity, but we cannot see how technology is eliminating the safety issues which arise when banking is mixed with commerce and the offering of various financial services.

Technology seems to be raising more safety issues than it is solving.

The AARP is concerned that the communication revolution may be spawning a host of new problems in terms of protection for consumers. The association does not favor S. 2181 at this time. Our position is based on a number of points.

Point No. 1. Historically holding companies have been anticompetitive, not procompetitive. The stockholders of a holding company look to the management to properly operate the subsidiary companies of the holding corporation. Obviously, the subsidiary companies are not going to compete with one another. Instead, they will tend to be mutually supportive. If a commercial bank is made part of a holding company complex, it will tend to support its affiliated companies.

Of course, laws and regulations can be fashioned to try to promote competition and deny mutual support among affiliates. But we must deem these efforts impractical from an administrative point of view.

With respect to holding company affiliates competing with others, including the so-called financial supermarkets, we would point out that commercial banks have Government supported advantages which make it inequitable to set them up in competition with other entities which lack these same Government supported advantages.

Point No. 2. Commercial banks with deposit insurance operate with implicit capital which arises from the nature of deposit insurance and the manner in which it is administered. In the event of insolvency, the uninsured creditors are made whole along with the insured depositors. In the event of credit stringency, these banks may borrow from Federal agencies, including loans of last resort.

These financial advantages are very significant. Bank managements, if they're so inclined, may trade on the implicit capital provided by deposit guarantee and by Federal agency lending support.

Point No. 3. It seems a bit strange at this time to be inviting commercial banks to expand their operations into new and varied fields. Many of the largest banks have loaned out more than their capital to foreign countries. Defaults on some of these loans cannot be ruled out. It would seem to be time for raising capital requirements rather than urging these banks to expand their commitments based on their present capital.

The CHAIRMAN. If I might just interject there, capital requirements were raised and disclosure requirements and new reserves in the IMF quotas increased.

Mr. HACKING. Thank you.

Point No. 4. As a condition precedent to allowing commercial banks into new commercial and financial activities, deposit insurance should be reformed so that banking activities reflect market forces, removing from them the advantages of the implicitly supplied capital. We must cease routinely bailing out the unsecured creditors of failing banks, thereby enforcing prudence by creditors when making advances to banks. We must cease allowing single parties to make large numbers of $100,000 deposits, all of which are insured. Deposit insurance was originally and properly conceived as protection for small depositors.

Deposit insurance should be roughly related to risk. It is clearly inequitable that conservative bankers should end up supporting the activities of high-risk bankers under a flat insurance premium.

PROPOSED DEREGULATION COULD PROMOTE MORE INFLATION

Finally, the association is greatly concerned about whether or not the deregulation proposed under S. 2181 would promote more inflation. It is unclear whether or not the Federal Reserve System will be able to satisfactorily monitor the expansion of money and credit which can take place under this deregulation and thus control inflationary pressures.

Inflation is not only damaging to the elderly, but it is damaging to the Nation's economy. The association believes that the huge Federal budget deficits overhanging the economy are virtually certain to build up inflationary pressures as long as Congress and the administration will not meaningfully deal with these deficits. The only force in Washington standing between the citizens of this country and a renewal of double-digit inflation is the restraining policies of the Federal Reserve System over the expansion of our paper money supply.

That concludes my remarks, Mr. Chairman. Thank you.

[The complete statement follows:]

STATEMENT
of the
AMERICAN ASSOCIATION OF RETIRED PERSONS

I. INTRODUCTION

My name is James M. Hacking, and I am Assistant Legislative Counsel of the American Association of Retired Persons. With me today is Ralph W. Borsodi, an Economic and Financial Consultant to the Association. I wish to thank the Chairman and the members of the Committee on behalf of our membership of over 15 million persons for this opportunity to speak on the subject of deregulation of the banking and financial services industry and, specifically, on S. 2181, a bill which would authorize depository institution holding companies to engage in various financial service activities.

These activities would include insurance underwriting and brokerage, real estate development and brokerage, and certain securities activities including: dealing in, underwriting and purchasing government and municipal securities, sponsoring and managing investment companies and underwriting the securities of such companies. The purpose of the sponsors of the bill is to promote competition in financial services by allowing commercial banks to expand into financial activities, which were formerly thought to be too risky for the safety of commercial banks. Early regulators of the commercial banking system feared that banking power combined either with other financial interests or with commercial interests would be likely to reduce rather than enhance competition.

It is curious that today the holding company concept has come to be viewed as a benign device, whereas late in the last century, and early in this century, holding companies were greatly feared as promoting the anticompetitive and monopolistic "trusts". On this we seem to have come full circle. The holding companies are supposed to bring us the benefits of competition, the benefits of new technology in the computer and communication fields, the benefits of large scale operations, and the doubtful benefits of conglomerate management. These management benefits are doubtful because it is a rare set of directors and corporate officers who can exercise superior judgment in a wide variety of business activities.

The holding company concept has no history of promoting competition. The holding company concept does not prevent management from assuming a variety of risks, which are beyond profitably managing. Should this occur and should a bank be affiliated with insolvent firms held by the holding company, there could be losses which undoubtedly would fall on the deposit insurance system and other agencies of the goverment (which make loans of last resort). Under deposit insurance it has become a principle that almost no depository institution is liquidated. The costs of administering this principle fall on the depository insurance system and on the taxpayer.

II. THE SAFETY CONCERNS OF THE ELDERLY

Elderly persons and mature individuals who are planning for retirement have a keen interest in the safety of the financial institutions with which they have dealings. There are constant reminders that this interest is not misplaced. Last year, Baldwin-United filed for reorganization under Chapter 11 proceedings, after having sold some $4.5 billion of annuities. These annuities were sold as safe investments by the large brokerage houses, with which S.2181 would encourage the bank holding companies to compete. These annuities were widely sold in interstate commerce, although the state laws which covered the transactions failed to prevent the large losses which the buyers of these financial services will certainly incur. We would wonder that we should not be looking at federal legislation to improve the safety of financial services sold in interstate commerce, before promoting these same sales through bank holding company subsidiaries. At least the purchasers of financial services should be furnished by the seller, or by the seller's agents, with a full and understandable disclosure of the investment plans for his funds.

When we think of concern for safety, we wonder about the lending practices of the larger commercial banks which frequently make foreign loans in excess of their capital.

III. COMMERCIAL BANK FOREIGN LOANS

Studies made by the Institute of International Economics late last year found that outstanding loans to just five Latin American countries exceeded 150 percent of the capital of the nine largest commercial banks. The worldwide recession, from which our Latin American neighbors are still suffering, has converted some of these loans into the category of nonperforming loans, a gray area between active loans and loans in default. The borrowers on a number of these loans were not able to meet their interest obligations, entailing new and larger credit lines from the banks. The banks are not pressed by government regulators to call any of their loans nonperforming, because that would reduce bank earnings, reduce the value of the bank shares in the markets, raise the cost of borrowed capital for the banks, and generally undermine confidence in the entire financial system. In fact, foreign government borrowers have learned from us (and others) that government debt is never paid off, but continually rolled over. (Ultimately, it is reduced to manageable proportions by inflation of the national currency.) The banks are encouraged to extend these foreign loans in the interest of promoting foreign development and in the interest of promoting foreign trade.

Among the worrisome aspects of this big buildup of debt are the rising contingent liabilities of the United States (arising from the fact that its agencies will shield the banks from the effects of foreign loan defaults) and the fact that domestic borrowers must compete for funds at interest rates which are bound to be sustained by profitable foreign lending.

In early October of last year, at the annual meetings of the International Monetary Fund and the World Bank, H. Johannes Witteveen, the former managing director of the I.M.F., stated that "Our monetary system is in a rather frightening state". However, the U. S. Government stands behind the large commercial banks. The ordinary U. S. citizen is not frightened by the state of the international monetary system, since he sees his own national banks as protected by the U. S. Government. Nevertheless, the growth of U. S. government indirect obligations and its direct obligations for debt threaten the revival of inflation as the means for relieving debt pressures.

IV. SELECTIVE GOVERNMENT HELP MAKES UNFAIR COMPETITION

The U. S. Government, through deposit insurance, and through loans of "last resort", protects the commercial banks from the ultimate penalty of bankruptcy should the banks fall in the competitive race. This raises several problems for competitors of the holding company firms and for the Government. Is the conventional competition to be provided with "last resort" loans and some new forms of deposit insurance? After all, we can not have one side of the playing field on high ground, with the other side on swampy ground.

One is also obliged to give much consideration to the fact that the way deposit insurance is now administered by the federal government results in the creditors of commercial banks, other than the insured depositors, being guaranteed repayment by the federal government in the event the insured institution becomes insolvent. Of course, if any corporation has its creditors suitably protected against losses by guarantees, it has that much less need for capital, and may well find that it can borrow at lower interest rates than its competitors.

Under federal deposit insurance, commercial banks have not only the capital stated on the balance sheet, but also the implicit capital provided by the mechanism for settling deposit insurance in the event of insolvency. This implicit capital provides the commercial banks with substantial advantages as a competitor in financial services markets, even as a subsidiary of a bank holding company. In fact, we believe it improper to widen the powers of bank holding companies without reforming the deposit insurance system. The studies on deposit insurance initiated by this Committee point to the same conclusion. The private sector has also been pointing out that federal deposit insurance has had unintended effects and is in need of reform.

V. REFORMING DEPOSIT INSURANCE (PRIVATE SECTOR ANALYSIS)

Mr. Anthony Downs, a senior fellow with the Brookings Institution in Washington, D. C., has researched federal deposit insurance and reported on his conclusions and recommendations in the Wall Street Journal of September 26, 1984, from which we quote:

> "Federal deposit insurance, which just celebrated its 50th anniversary, recently has been having two undesirable effects quite different from its original purpose. One is providing a cost advantage in raising funds for institutions with such insurance. The other is permitting their managers to undertake riskier activities than they otherwise would. These effects will be aggravated by both financial deregulation and by electronic banking. So it is time to review the relationship of federal deposit insurance to our whole financial system."

Mr. Downs arrives at the same general recommendations as others who have studied federal deposit insurance: the insurance has the bad effect of insulating the insured institutions from the discipline of market influences. Mr. Downs emphasizes in his recommendations the original purpose of deposit insurance -- protection of small depositors.

We quote Mr. Downs again on his recommendations for reform. Speaking of deposit insurance, he writes:

> "...we need to make the institutions using it much more sensitive to investment risks. One way is forcing them to face a market test in attracting a sizeable share of their deposits. Therefore, the maximum amount federally insured in any account should be $50,000 or even lower. Also, no person or company should be allowed to own or participate in the ownership of more than one insured

> account in an institution..... A second desirable tactic is gradually increasing the amount of capital reserves each insured institution must hold to retain federal insurance eligibility. Those reserves should be pushed upwards to a long-range target of 6 to 8% of total assets. Greater reserves would protect both depositors and taxpayers (through federal insurance agencies) from paying for substantial initial losses in each institution. This requirement would also make managers of these institutions much more sensitive to risk. Another tactic is charging insured institutions differential premiums, depending on the riskiness of their behavior as determined by federal regulators. However, measuring such riskiness is extremely difficult in practice."

VI. REFORMING DEPOSIT INSURANCE (ACADEMIC ANALYSIS)

Professor Edward J. Kane of Ohio State University is a distinguished academic analyst of our central banking system and of the private banking system. Professor Kane finds -- as we have -- that deposit insurance, as presently administered, is providing the commercial banking system with most substantial amounts of implicit capital. (Of course, loans of last resort made to banks in trouble by federal agencies constitute explicit capital.) The Federal Government, in supporting the continuation of insured banks -- no matter what practices have led to insolvency or near insolvency -- is pursuing a policy of treating banks as if their interests are to be identified with the national interest. Administratively, under deposit insurance a Purchase and Assumption transaction takes place under which the federal deposit insurance agency replaces the bad assets of an insolvent bank with cash so that deposits and nonsubordinated liabilities of the insolvent institution can be assumed by another bank, either existing or new. This procedure is said to be cheaper than paying off the insured depositors and it avoids the disruptions of lengthy bankruptcy proceedings. However, the Purchase and Assumption procedure has important, unintended financial consequences. As Professor Kane explains it in a paper entitled, "A Six-Point Program for Deposit Insurance Reform":

> "A policy of routinely bailing out all but each agency's most devastated clients has induced a massive and ongoing substitution of equity in the form of deposit-insurance guarantees for private equity in deposit institutions..... To reverse this momentum, incentives to invest private capital in deposit institutions must be restored."

Professor Kane is a strong advocate of deposit insurance reform along the following lines:

First, full disclosure should be made of adverse information concerning the operations of an insured deposit institution. The management of the depository institution and its creditors will then be influenced by market factors when determining their actions.

Second, insurance coverage should be recalibrated so that the insured party becomes aware of the costs of insurance of his deposit.

Third, the premiums charged by the government for deposit guarantees should be explicitly risk-related. It is difficult to determine the variable risks and to set differential premiums. Nevertheless, the logic of setting variable premiums is inescapable.

Fourth, meaningful opportunities should be provided for private competition in deposit insurance.

This should not be a government monopoly.

Fifth, the opportunities should be expanded for deposit-insurance agencies to manage their risk exposure. Failing institutions should not be allowed to make "end-plays", greatly increasing losses to be borne by the deposit insurance funds and by the taxpayers under P. & A. procedures.

These points argue strongly for reform of deposit insurance.

VII. INSURANCE REFORM -- A PRECONDITION TO DEREGULATION

Before commercial banks are deregulated to engage in a variety of financial services, which will entail a variety of different types of risk, deposit insurance must be reformed, so that the risks of the particular banking operations performed by the bank are reflected in its deposit insurance rates. In addition, when a bank holding company can legally acquire a financial or commercial operation as a subsidiary, the deposit insurance rates for its subsidiary bank should reflect the risks of the business conducted by affiliates. The present deposit insurance system of charging level premiums based on deposit insurance levels bears no relation to the risks imposed on the government's deposit insurance agencies by the insured institution. An insured institution operating in a rural county, run on conservative banking principles, bears the same rate of deposit insurance as does a large city commercial bank, which is vigorously engaged in promoting its growth. This would not make sense to a private auto insurance company, which would insist on higher premiums from drivers with a record of motor vehicle violations. In addition to the need for rate reform, the Purchase and Assumption method for salvaging insolvent banking institutions needs to be modified so that the uninsured creditors are subject to market forces. Under the P&A transaction, sometimes referred to as a Phoenix transaction (because the insolvent company arises renewed from the ashes), the uninsured creditors are completely bailed out by the federal insurance agency.

These reforms, as outlined immediately above, are needed before banks are deregulated to engage in new financial services. It is a mistaken thought, as we have already pointed out, that the bank holding company procedure insulates the bank subsidiary from affiliated companies. The holding company shareholders will hold the management responsible for evolving a system of mutual support among the holding company subsidiaries. In a period of tight credit, it is difficult to imagine the holding company's banking subsidiary informing its affiliated real estate company that a vitally needed credit line is not available, since the funds had been promised to an outside firm. The presumption that laws and regulations can prevent mutual support among the holding company subsidiaries ignores the difficulties of policing the infractions of such laws and regulations. It is believed that the only correct approach is to reform deposit insurance prior to deregulation, so that insured banks cannot convey inequitable competitive advantages to affiliated companies.

VIII. DEREGULATION AND INFLATION

The elderly are grateful for the decline in inflation over the past three years from roughly 12 percent per annum to somewhat less than 4 percent. We are mindful, however, that following the abandonment of the Nixon price controls in the mid-1970s, inflation swiftly rose from low levels to double-digit levels. There seems to be some complacency that the inflation problem has been solved by the past three years of disinflation and that we have no need to worry over it again. Nevertheless, high federal government budgetary deficits have produced an inflationary climate in the past, particularly when military spending is an important source of the deficit. Our Association looks to the Federal Reserve System to contain inflation by exercising a constraining policy of monetary expansion. We are concerned that "deregulation" of the commercial banks may make it more difficult for the Federal Reserve Board to exercise informed restraint over the expansion of the money supply. The evidence is that deposit insurance has dulled the market restraints that should inhibit bank managements -- should they be so inclined -- from engaging in what has been called "go-go" banking. These issues must be thoroughly debated. We are not interested in an inflationary boom, fueled by the excessive expansion of money and credit. Inflation is a major threat to the economic wellbeing of the elderly. Combining commercial banking, as it is now subsidized by deposit insurance, with commerce and financial services appears to us to be a volatile mixture.

IX. SUMMATION

The American Association of Retired Persons is a strong believer in the salutary effects of free markets and competition in restraining price increases. We have pressed for a decade the freeing of depository institutions from the baleful effects of interest rate ceilings. We are desirous of promoting competition among those who offer financial services. However, commercial banks, and financial institutions by any other name, which have the power to create deposit money against fractional reserves have very special powers given to them by the state and federal authorities. Their activities have been carefully circumscribed by every government, because of the great power inherent in the ability to create money. The States and the Federal Government charter commercial banks and have seen fit in the past to circumscribe their activities. It is now said that the advances in computer technology and in communications dictate that commercial banking should be free to engage in various commercial and financial activities from which they have been in the past prohibited. We can understand how technology is breaking down geographical limitations on doing business. But we do not see how technology is eliminating the safety issues which arise when banking is mixed with commerce and the offering of various financial services. Technology seems to be raising more safety issues than it is solving. As far as we know, there has been no intensive study by Congress of the problems of regulating the volumes of new types of transactions, which the communications revolution is developing between the States. Just as computer fraud has been a mystery to the bulk of business managers, our Association is concerned that the communication revolution may be spawning a host of new problems in terms of protection of consumers.

The Association is opposed to S.2181 for a variety of reasons:

1. A holding company does not make for competition, but tends to reduce competition. The stockholders of a holding company look to the management to profitably operate the subsidiary companies of the holding corporation. Obviously, the subsidiary companies are not going to compete with one another, but in one way or another, they will tend to support each other. If a commercial bank is made part of a holding company complex, it will tend to support its affiliated companies. Of

   course, laws and regulations can be fashioned to try to promote competition and deny mutual support among the affiliates. We must deem these efforts impractical from an administrative point of view. With respect to the holding company affiliates competing with others, including the so-called financial supermarkets, we point out that commercial banks have government supported advantages, which makes it inequitable to set them up in competition with other entities which lack these goverment supported advantages.

2. Commercial banks, with deposit insurance, operate with implicit capital, which arises from the nature of deposit insurance, and the manner in which it is administered. In the event of insolvency, the uninsured creditors are made whole, along with the insured depositors. In the event of credit stringency, these banks may borrow from federal agencies (including loans of "last resort"). The financial advantages outlined are significant. Bank managements, so inclined, may trade on the implicit capital provided by deposit guarantee and by federal agency lending support.

3. It seems a strange time to invite commercial banks to expand their operations into new fields. Many of the largest banks have loaned out more than their capital to foreign countries. Defaults on some of these loans cannot be ruled out. It would seem to be time for raising capital requirements, rather than urging them to expand their commitments

based on their present capital.

4. As a precondition to allowing commercial banks to enter new commercial and financial activities, deposit insurance must be reformed, so that banking activities reflect market forces, removing from them the advantages of implicitly supplied capital. We must cease routinely bailing out the uninsured creditors of failing banks, thereby enforcing prudence by creditors, when making advances to banks. We must cease allowing single parties to make large numbers of $100,000 deposits, all insured. (Deposit insurance was originally, and properly, conceived as a protection for small depositors.) Deposit insurance should be roughly related to risk. It is clearly inequitable that conservative bankers support the activities of "go-go" bankers under a flat insurance premium.

5. Meaningful deposit insurance reforms should be made before any deregulation of the type proposed under S.2181 is made.

6. The Association is greatly concerned as to whether or not the deregulation proposed under S.2181 will promote more inflation. It is unclear whether or

not the Federal Reserve System will be able to satisfactorily monitor the expansion of money and credit, which can take place under this deregulation, and thus control inflationary pressures. Inflation is not only damaging to the elderly but is damaging to the economy. The Association believes that the huge federal budgetary deficts overhanging the economy are virtually certain to build up inflationary pressures. As long as Congress will not meaningfully deal with the deficits, the only force in Washington standing between the citizens of this country and a renewal of double-digit inflation rates is the restraining policies of the Federal Reserve System over the expansion of our paper money supply.

The Chairman. Thank you, Mr. Hacking.

Gale, where have you been? You haven't been before the committee for a long time.

Ms. Cincotta. Well, you haven't invited me for a long time, but I have met with Danny Wall in Chicago for a couple of days in fact.

The Chairman. Well, we're happy to hear your testimony.

STATEMENT OF GALE CINCOTTA, EXECUTIVE DIRECTOR, NATIONAL TRAINING AND INFORMATION CENTER

Ms. Cincotta. Thank you.

My name is Gale Cincotta. I am executive director of the National Training and Information Center in Chicago. We deal with community groups across the country, senior organizations, housing and economic development organizations also.

[The complete statement follows:]

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Testimony of

Gale Cincotta
Executive Director

NATIONAL TRAINING AND INFORMATION CENTER

My name is Gale Cincotta. I am executive director of the National Training and Information Center in Chicago and chairperson of National People's Action, a coalition of community groups throughout the country.

Almost nine years ago, I appeared before this committee to testify in favor of the Home Mortgage Disclosure Act, HMDA. Seven years ago, I testified before this committe for the passage of the Community Reinvestment Act. Today, I am here to raise fundamental questions as to what financial deregulation offers for America's neighborhoods, for low and moderate income families, and the American economy overall.

The last several years has given us legislation and regulations which have deregulated interest rates. Now, the "Financial Services Competitive Equity Act" (S 2181) proposes to give us product deregulation by expanding financial institutions' powers. In addition, states are banding i [illegible] pacts to prepare for the future onslaught of geographical [illegible] 2181 would ratify this regional preparation while the Citicorp [illegible] continues to howl for its "freedom" to roam nationally at th [illegible] continues to go to every back door in every state it can find.

Yes, [illegible] has changed. But I insist that while some players cry for a "level playing field," consumers are being run over in terms of both services and credit needs. You can point your economic finger where ever you want, but as far as I am concerned, banking deregulation has condemned us to high interest rates.

In today's deregulated atmosphere, competition is based primarily on the interest rates paid to depositors. Now that banks are paying close to 10% interest on certificates of deposit, they are charging more for their loans. Four years ago, the discussion in Congress was that American savers deserved a better return on their savings than stuffed animals. Everyone insisted that we had to stop the unregulated money market mutual funds which have drained almost $200 billion in deposits from the banking system.

Call me old fashioned, but I prefer government regulation to deregulated banking and higher interest rates for eternity. Money market funds should have been regulated in 1982 and looked at for their social and economic impact instead of allowing banks to pay money market-oriented rates.

We are again asking the wrong questions: Should banks be allowed to sell insurance? Should securities firms, insurance companies, and department stores be allowed to buy banks? Instead we should be asking what kind of banking system do we need: What are the credit needs of American consumers and businesses? What kind of services are vital to every day life?

Time Magazine heralds that "Banking Goes National." The New York Times poses: "A Banking Puzzle: Mixing Freedom and Protection." The question is not how do we deregulate the financial services Rather, we should be asking what kind of regulations must we have for this new national financial services market,

We are talking about massive amounts of capital. How do we assure that such economic power is not abused? How do we assure that the little person is not "nickled & dimed" by high service fees? How do we assure that credit and services are available for all and not just a class of Americans who can afford to pay high interest rates and keep thousands of dollars on account?

There is a fundamental "quid pro quo" involved with our financial system. If financial institutions are to have their deposits insured by the government, if they are to have access to such privileges as the Federal Reserve's discount window, they must be willing to accept their public responsibility and government regulation to hold them accountable to that responsibility. Financial institutions can not ask the American public for deregulation and the freedom to gamble at will and expect us to cover their bets at the same time.

In 1977, Congress voted that "regulated financial institutions have a continuing and affirmative obligation to help meet the credit needs of the local communities in which they are chartered." The Community Reinvestment Act (CRA) states clearly that "regulated financial institutions are required by law to demonstrate that their deposit facilities serve the convenience and needs of the communities in which they are chartered to do business," and that the convenience and needs of communities include the need for credit services as well as deposit services.

I am telling this committee that this federal law is not being enforced. We are opposed to S 2181 because it totally ignores this federal law.

S 2181 would grant new powers to financial institutions without holding them accountable to their compliance with CRA. I have strong fears and doubt about further deregulation of the industry and I am also specifically concerned that compliance with CRA is not included as one of the criteria for consideration in the granting of any of these proposed new activities.

The game has changed since 1977 and it is time that bank and S&L holding companies and any corporation which offers financial services are subject to CRA. The parent (namely, the holding company) should be held accountable for the sins of its children (namely, its subsidiary banks). Holding companies should not be granted additional powers or subsidiaries while their banks or thrifts fail to fulfill their legal obligations. Other corporations, whether they be insurance companies or department stores, should not be permitted to accept deposits or make loans without accepting their obligation under CRA.

Last September, we presented specific amendments to the "Financial Institutions Deregulation Act" (S 1609) to staff and members of this committe, to Paul Volcker, and to officials of the Treasury Department. These amendments are germane to S 2181 as well:

1) Amend the legislation to include review of an institution's compliance with the Community Reinvestment Act of 1977 as a fifth criteria of approval of an institution's application for any of the new powers granted in this bill.

2) The above amendment would specifically call for a review of an institution's practice of closing community branches as part of this CRA review.

3) Amend the legislation to require the Federal Reserve Board to disclose the CRA rating and exam reports for any institution applying to engage in these new permissible activities.

4) Amend the legislation to make applications for these new activities subject to CRA challenges with public notice and a comment

period for protest by communities.

5) Amend the legislation to require disclosure by an applying institution of their small business loans.

Over a dozen community leaders of National People's Action discussed the impact of present and potential deregulation on low and moderate income neighborhoods with Comptroller of the Currency Connover this past Monday. We also raised the pressing issue of branch closings and informed Mr. Conover that his agency has a dismal record of enforcing the Community Reinvestment Act.

We proposed a joint task force between the Comptroller's Office and NPA to develop recommendations to improve the CRA enforcement. We also requested that NPA leaders be invited to participate in a series of cross-sector forums on deregulation, sponsored by the Comptroller.

Whether or not a productive dialogue is so fostered, CRA enforcement is the critical missing ingredient in the deregulation stew we are being asked to swallow.

I would recommend that this committee request a Government Accounting Office (GAO) review of CRA enforcement by the Office of the Comptroller of the Currency. It is the major national banks, who are pushing for and have so much to gain from deregulation. The Comptroller is supposed to be regulating and enforcing existing federal laws in light of their performance in fulfilling their CRA obligations.

Groups in New York like the Coalition Against Redlining, represented by Pauline Wilson today, and the Northwest Bronx Community and Clergy Coalition have filed six CRA challenges with the Federal Reserve and the Comptroller over Citibank. These challenges have been denied based on the Comptroller's CRA examination of Citibank.

Citibank is not only a prime example of the lack of regulation by the Comptoller and the Federal Reserve Board. Citicorp is a prime example of the lag in Congressional action on financial service regulation, not deregulation.

Citicorp has made major moves into California, Illinois and Florida with its acquisition of First Federal in Chicago and New Biscayne in Miami in addition to their earlier acquisition of Fidelity Federal in Oakland. Citicorp has established "Person-to-Person" consumer lending offices in 28 states. They have commercial lending offices in many major industrial cities.

Citicorp has had a clear agenda of creating a national, deregulated banking arena. Through a reciprocity agreement, they're moving into Maine. Speculation has it that they will be able to break into the rest of the New England market by raising legal, constitutional questions about the exclusion of non-New England states from the market.

Citicorp is moving into Kentucky and Tennessee with industrial banking. They're working on getting into the Maryland and North Carolina markets. They were just beaten back from New Mexico's door. They have been in South Dakota for some time. Word has it that they are also shopping for a bank in Illinois now that they have an S&L.

I'm submitting for the record my testimony before the Federal Reserve Board on the Citicorp acquisition of First Federal, as well as a copy of our Request for Reconsideration. Some of our concerns about the resultant lending condition from the Fed's order are discussed in these materials.

I don't want to get off the point of the issue before us today. I have raised Citicorp only as a prime example of the dilemma we face, as consumers, as representatives of neighborhoods in cities across the country who have fought hard and long for real community reinvestment and don't want to lose access to lending institutions.

One path before us is continued piece meal deregulation, where the industry is making the decisions with every loophole they find. Another path is offered by S 2181 for Congress to pass full deregulation and run the risk of bank monopoly of this country's capital. Or we can call time out and re-regulate the industry, taking into consideration the already changed nature of financial services in 1984.

Walter Wriston may see it as a shootout between individual liberty and authoritarian government. But as far as I know this is still a government of the people, by the people and for the people. It was Woodrow Wilson who warned in 1908 that: "The banks of this country are remote from the people and the people regard them as not belonging to them but as belonging to some power hostile to them." Deregulation will ensure that this statement will be as true eighty years later by 1988.

I acknowledge that a thorough revamping of federal laws and regulations must be made to accommodate the changes that already exist in what has become a national financial services industry. But I am proposing that such a revamping by Congress ensures that the financial services industry is held accountable for the privileges that they are granted, whatever they may be. I am requesting a strengthening and extension of the Community Reinvestment Act to the entire national financial services industry.

If American Express, J.C. Penny, Sears, Dreyfus, Beneficial, Parker Pen and Western Family, a chain of furniture stores, want to play in the financial game, they all must play by the same rules and meet the credit and service needs of the communities where they are doing business. This is what we call a level playing field!

On February 17, the Comptroller of the Currency approved an application for a "nonbank bank" that had been submitted prior to their moratorium by the FMR Corporation, which operates the Fidelity Group of mutual funds. What's Fidelity and FMR doing for the credit needs of our communities? If Merrill Lynch is "bullish" on America, why aren't they bullish on our communities? We're Americans who want a place to live, to work and to shop.

This country's capital is being pulled out of banks and thrifts by these megafinancials. Our credit needs for housing and commercial loans are not being met.

We have no national data on commercial lending but the Home Mortgage Disclosure Act documents continued redlining by conventional lenders. The most recently available aggregate HMDA data is for 1982 and was only available publicly last month. Preliminary analysis of this data continues to show patterns of racial and geographic discrimination. For example:

Chicago 1982 data shows that 38.5% of the census tracts in the Chicago SMSA area have a minority population of forty percent or more. These census tracts, however, only received 8.4% of the total housing lending in the SMSA during 1982. The census tracts with less than thirty-nine percent minority population account for 61.5% of the SMSA's total number of census tracts. However, they received 91.6% of the SMSA total housing dollars.

In 1982, the city of Chicago only received 22.7% of the total housing lending in the SMSA while the suburbs received 77.3%. Three lakefront communities received 29% of the city's total housing dollars. The top fifteen communities account for 59% of the city's housing dollars, while 62 of Chicago's 77 neighborhoods only received 41% of the city's housing dollars.

This pattern can be seen in cities of various sizes. In Camden, New Jersey, the city of Camden only received 3% of the county total, even though 13.5% of the County's homeowners live in the city of Camden. Three Camden neighborhoods have the same amount of owner-occupied units as one suburb. The suburb received 150 loans for $3.8 million while the three neighborhoods only had 31 loans for $300,000 combined.

The city of Boston represents 28% of the SMSA's census tracts. However, Boston only accounted for 14% of the SMSA's total housing lending in 1982. The Beacon Hill and Back Bay census tracts received 30% of the city's housing lending, although they constitute only 8% of the city's census tracts.

In Syracuse, New York, comparisons showed that two suburban communities received 10.8% of the total while two low and moderate income city neighborhoods only received 1.2% of the SMSA total in 1982. The city itself only received 15% of the SMSA total.

In Sioux City, Iowa, eight city census tracts account for 32% of the city's total population and 37% of the city's total housing units. In 1982, these eight tracts received only 12% of the dollars lent.

I am submitting for the record, reports from these cities. Other cities are still in the process of analyzing this 1982 HMDA aggregate data. The Home Mortgage Disclosure Act remains a vital form of public disclosure for monitoring the lending industry.

HMDA should be extended before its sunset in 1985 and it should be expanded to include other new financial institutions. There is no reason, for example, that Citicorp's "Person-to-Person" offices should not have to disclose the location of their loans. Their Schaumberg, Illinois office did $75 million in mortgages in 1983. What did they do for meeting the city of Chicago's housing needs?

HMDA should also be complemented by disclosure of commercial and small business lending. Chicago has a city ordinance that requires recipients of city funds to disclose their consumer and commercial lending. The commercial lending data shows similar patterns of concentrations in only a few communities that the aggregate housing data does. Our community credit needs go beyond housing and the public's right to know remains a fundamental issue.

The Community Reinvestment Act also applies to service needs as well. Some of NPA's leaders attended a conference earlier this month in New York on deregulation. Pauline Wilson will tell you next about the promise of future lending institutions that community people were presented there. But some of the stories I have heard seem to echo from city to city.

"Personal banking" is the business the big banks and the big nonbanks want to get into. Everyone wants to be the ultimate source for all personal banking services for the "upscale" customer. What does that mean for the future?

If the industry decides whom they will and will not serve, we will see discrimination in this country much broader than racial or geographic discrimination. If credit is not affordable and available to every economic and geographic segment of our society, then a major percentage of American society will not be able to participate in their own economy.

We simply cannot succeed in this country as individual family homeowners, farmers, small business people or even parents who want to borrow to improve the quality of their children's lives unless we have access to convenient banking deposit services and affordable and available credit.

Working class and lower income communities in New York, Philadelphia and California are faced with major banks shutting down branches in their communities.

CRA, as it now stands, does not come directly into play with branch closings. They are denying traditional services to these communities in order to pursue their corporate plans for new product and geographical arenas.

It's no secret that many of this country's financial movers and shakers want to eliminate the majority of this country's banks. According to some Wall Street wizards, we have 12,000 too many banks. Eliminate 80% of this country's banks and we've got trouble.

What's going to be left after all the dust settles? If we need to have minimum balances of $2,500 to open an account, Sears better start selling mattresses with safes built in as the next part of their financial network. And what about the American tradition of encouraging your children to save and plan by having them open a bank account that they can add a dollar a week to?

In closing, I would like to react to some of the specifics in this legislation. First, I prefer Senator Proxmire's bill (S.2134). One reason is that it would stop non-financial firms from buying savings and loan associations unless it retains its commitment to housing finance. In addition, it would also prevent bank holding companies from engaging in nationwide insurance activities.

Secondly, "consumer banks" as proposed in this legislation in particular must be subject to extended CRA and HMDA requirements.

Thirdly, if the thrift industry is to be regulated differently, the "qualified thrift lender" test must be included and enforced to assure the continued status of thrifts as a specialized housing finance industry.

Fourth, payment of interest on reserves held by the Federal Reserve will benefit primarily large institutions. In return, they should be willing to target such payments as proposed by Congressman Robert Garcia in HR 4511, introduced on November 18, 1983. This bill would allow financial institutions to earn interest on reserves if 50% of the money earned on interest is loaned in distressed areas and if they have a Community Reinvestment Act rating of "1". A public purpose must be served for future privileges.

Fifth, I believe it is sound judgment to limit the acquisitions and mergers between large financial organizations and the largest bank and thrift holding companies. "Megafinancials" is already a big enough concept without more merger mania.

Finally, the ratification of regional interstate banking would move us too swiftly toward geographical deregulation from which we will never be able to return. Rather, Congress should prohibit any further state action. This section opens the flood gate despite its provisions for a sunset and a report.

This continued tinkering with various apects of financial regulation is not enough. We cannot afford to wait and let the industry dictate the rules by which they will profit and our communities will perish.

In conclusion, I respectfully recommend that the committee scrap plans for further deregulation and undertake an omnibus bill that will regulate all the new financial actors and hold them accountable for meeting the service and credit needs of all Americans. Thank you.

Attachment A

Testimony of
Gale Cincotta
Executive Director
NATIONAL TRAINING & INFORMATION CENTER
on

The Application Filed by
Citicorp to acquire First
Federal Savings & Loan Assoc.
before
the
FEDERAL RESERVE BOARD
Washington, DC January 11, 1983

Some years ago, in Illinois, we and the community organizations with whom we are affiliated, were very concerned about potential changes in state law that would allow banks to branch. We were also concerned about rumblings that the McFadden Act would be amended to allow inter-state banking. People were rightly concerned then and now, about the potential monopolies in banking and what that would do to the tradition of available and affordable credit for the small borrower, the home owner, the small businessperson, the average American.

As other people have, and will testify to, today, Illinois has a strong history of unit banking. Commercial banks are allowed only 3 branches, and those only a few miles from their home office. Community organizations fought hard to keep branching limited.

This hearing today teaches us what we could not have foreseen when we were first involved -- back in 1975. We could not have foreseen that major changes -- not only in the economy of our neighborhoods, but our city, our state, and even the country -- would be made well outside the legislative process. I am here today to object strongly to the process of such decisions and particularly to the senseless approval of a sale by the FSLIC of First Federal Savings and Loan Association to Citicorp.

We are told, as consumers, very little about the value of the proposed Citicorp takeover. In fact, consumers and community groups have not been informed about much at all, including hearings and applications. We've learned most of what we know -- after the fact, from newspaper coverage.

What we do understand, however, is that Citicorp has basically decided not to wait for liberalized branching laws in Illinois, much less liberalized national banking laws. It seems that Citicorp and Walter Wriston have been thinking about this kind of approach for some time. We have a copy of their publication, "BANK ROBBERS GUIDE TO WHERE THE MONEY'S AT." Perhaps you've seen it. It seems to fit the theme we see here today -- of taking the law into their own hands.

It does not surprise me that a big bank like Citicorp wants to monopolize the industry and be the first and biggest nation-wide bank. But that such an affront to laws and regulations are aided and abetted by federal regulators and seemingly ignored by much of Congress, is an outrage.

I would like, for a moment, to address the role of First Federal as a lender in Chicago. They are a key resource for home mortgage lending. In fact, in 1981, they led all institutions in the city with the greatest percentage of assets in home mortgages. This resource is particularly significant in our current home loan picture, where total mortgage lending for 1-4 family units in Chicago in 1982 was only 25% of the total Chicago mortgage lending just two years earlier, in 1980.

And the city has felt the pressure of reduced over-all lending even more greatly than the suburbs. Total home lending decreased nearly 75% in the city in two years, and only 59% in the suburbs in the same time.

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table

HOME LOANS, ALL REPORTING BANKS AND INSTITUTIONS
(figures represent home purchase loans
for one-four family dwellings)

	1980	1982
Chicago/SMSA	$2,982,913 (100%)	$1,218,041 (40.8% of 1980)
Chicago/City Only	$1,022,401 (100%)	$251,632 (24.6% of 1980)

We need every city lending dollar we can get to overcome years of disinvestment. With all the strides we've made since the redlining/reinvestment movement started, high-cost lending has created an even greater pressure by outpricing working-class and middle-class people and jeopardizing the future of the thrift industry.

The future of the thrift industry is a major part of the discussion that should be going on here today. As I understand the story, First Federal's real emergency was nearly 2 years ago, in April of 1982, when FSLIC first targeted them as a "Phoenix" institution. Since then, FSLIC has played the major role in determining the policy and future of First Federal. As a part of this policy and decision making, FSLIC then ordered a merger between First Federal and First Financial of Downers Grove. This move proved to further endanger First Federal's net worth because First Financial turned out to be $200 million in debt. First Federal's former Chairman claims that his institution was forced to merge "under duress."

We then hear in June of 1983 that bids are being accepted by FSLIC for the sale of First Federal. Now, without much -- if any -- further public discussion, even with officials of the State of Illinois, FSLIC and the Bank Board give Citicorp the biggest Christmas present ever!

Three things are basically wrong with that decision. First of all, we don't want or need Citicorp in Illinois. Secondly, the decisions being made by FSLIC and the Bank Board to supposedly "protect" the savings and loan industry are turning out to be decisions that destroy the industry. And, finally, it's the wrong time and the wrong place to be deciding changes in Illinoic and federal banking law.

Let me tell you briefly whey we don't want Citicorp in Illinois. We don't need an out-of-state monopoly bank sucking out capital from Chicago and Illinois, and sending it around the country, if not around the world. We have enough trouble keeping our own big banks in line. In addition, Citicorp has a bad reputation among the neighborhood organizations in their home city. The Coalition Against Redlining -- or CAR -- is currently challenging Citicorp under CRA. Other groups have done so in the past. We asked CRA yesterday what message they wanted to give this body. Here it is:

> "CAR strongly opposes Citicorp's branch closing policy. These branch closings are primarily in low-income and minority neighborhoods and without warrant. The result is discrimination. And while Citicorp's lending record for home mortgages (that's 1-4 unit loans) within the city is strong,

> much of New York, and often in New York's low- and moderate-income neighborhoods, is made up of multi-family rental properties. Citicorp's record of making purchase and rehab loans for these vital New York structures is poor. This is clearly a local community reinvestment need that Citicorp should be meeting. We recommend that Citicorp be denied any new privileges until they have improved their record in New York."

Secondly, we question the commitment of the FSLIC, the Bank Board, and even Congress to sustaining a healthy home-mortgage lending industry in this country. The "Phoenix" strategy is apparantly not working. We've seen the FSLIC and the Bank Board sweep one institution under the rug of another, pump millions of dollars into the resulting institution, and then panicking and rushing to sweep it all under the rug of a big bank. Even then, we find that that's not a real economic solution. Citicorp's no savior riding in from the east to save us all in Illinois -- or California -- or Florida!

The facts of the matter are that we, as taxpayers, and other thrifts, as members of the Federal Home Loan Bank System, are and will be on the hook financially for some time. In California, Citicorp pumped in $80 million into the ailing S&L, but FSLIC agreed to spend up to $165 million over 12 years. In Chicago, Citicorp is putting up $118 million of initial capital. However, FSLIC in return, has already subsidized First Federal with more than $85 million and promised to cover Citicorp on possible losses and cost of litigation for 12 years, if necessary. According to Crain's Chicago Business, FSLIC's total tab could hit $350 million! They also point out that "It's a painful irony, since healthy Chicago thrifts would in effect be subsidizing Citicorp's arrival here."

Who are we saving from whom and for what purpose? There's an awful lot of money and promises of money passing back and forth with little promise of anything but a lead for Citicorp in national banking and a real competitive edge in the new financial services industry.

What about housing finance? What about long-term, low-cost housing credit? These questions begin to touch upon the third major reason we object to the FSLIC's and Bank Board's decision. That Citicorp wants further and complete deregulation is no secret. They've put together a flashy, razzmatazz brochure to describe their point of view. It's called "HOORAY FOR HOLLYWOOD."

Because Congress has taken a piece-meal approach to deregulation and virtually turned over its power to regulatory appointees, we are entertaining here today a regulatory consideration of interstate banking and over-riding of the McFadden Act.

We are suffering the consequences of creeping deregulation. In 1980 there was the "Depositary Institutions Deregulation and Monetary Control Act. Then the "Garn/St. Germain Act." Last year, the Treasury Department tried to give us the "Financial Institutions Deregulation Act." In the coming weeks, there will be consideration of the "Financial Services Competitive Equity Act," -- and probably others! And here we are today discussing the possible overthrow of serious banking laws: interstate-banking prohibitions, the McFadden Act! I contend that the Federal Reserve Board, the FSLIC, and the Federal Home Loan Bank Board cannot even use "emergency" as an excuse. Bids for purchase of First Federal were closed in June of '83. The FSLIC has had control of the institution since April of 1982!

Instead of further helter-skelter decision making on the nation's, and Illinois' banking system, we should be assessing the various actors in the new financial services industry. Perhaps the solution is not to further deregulate the regulated institutions, but to extend the regulations to the new, non-regulated institutions. Now that's the kind of "level playing field" we could live with.

We need responsible regulators to function in our behalf. When we didn't have adequate regulations, back in the 20s, get-rich-quick schemes of financial institutions nearly gutted our economy. Maybe the get-rich-quick schemes of 1984 are slightly different, and communicated quicker by computer, but the threat to our economy, our society, and the quality of life for the average American is again at stake.

There are too many unanswered questions. The Attorney General of Illinois' has, for one, questioned the legality of the FSLIC/Bank Board decision. And what about the role of the

Federal Reserve's high interest policies as a contributing factor to the thrifts' troubles? If Citicorp buys First Federal, will they continue to make home mortgage loans here? Will Citicorp close any of First Federal's 61 branches at will? Will a major percentage of First Federal Deposits be exported from Illinois? Is the Federal government, by its willingness to turn First Federal over to Citicorp, reneging on its responsibility to assure the availability of low-cost, long-term mortgage money?

I came here today to oppose the sale of First Federal to Citicorp and to reiterate the request we've already made in writing to the Federal Reserve Board. We want a local Chicago hearing. There is precedent in the Citicorp/Fidelity hearing that was held in San Francisco. And, further, it is my view that, since there is no real emergency situation at hand, the Community Reinvestment Act also prevails. We have already advised the Secretary of the Board, William Wiles, of our intent to protest Citicorp's acquisition of First Federal under CRA and exercise our full rights under this law.

I'm flying back to Chicago for a meeting tonight of community leaders who are determined that their reinvestment needs will not be trampled by Citicorp. I would like to tell them that their voices will be heard at a Federal Reserve Board hearing in Chicago.

National Training & Information Center
954 W. Washington Blvd., Chicago, Illinois 60607
(312) 243-3035

Preliminary Analysis of 1982 Aggregate Home Mortgage Disclosure Act (HMDA)

Fact 1: In 1980, the city of Chicago received 34% of the total housing lending in the SMSA and the suburbs received 66%.

In 1982, the Chicago SMSA area received 59% fewer housing loan dollars than in 1980. The city of Chicago received 73% fewer housing loan dollars than in 1980. The impact of high interest rates hit harder on the city than the suburbs.

In 1982, the city of Chicago only received 22.7% of the toal housing lending in the SMSA and the suburbs received 77.3%.

Fact 2: Three communities (Lincoln Park, Lakeview & the Near North) received 29% of the city's total housing lending. Twelve communities account for another 30% of the city's housing lending. The top fifteen communities account for 59% of the city's housing loans. (see Map 2)

The next thirty communities received 31% of the city's housing lending, while the remaining thirty-two communities only received 10%. So 62 of Chicago's 77 neighborhoods only received 41% of the city's housing loans.

Fact 3: When you break down the communities and look at census tract figures, the concentration of loans is even more clear. Some communities which made the top fifteen did so because they had one census tract with a high level of loans. In fact, out of the city's 868 census tracts, 56 tracts received more than a million dollars each in housing loans. These tracts, which account for only 6% of the city's total number of census tracts, received almost 40% of the city's loans. To no surprise, most of these census tracts are to be found on the city's north lake shore. (See Map 1)

Fact 4: Race is still a factor when it comes to housing lending. In the Chicago SMSA, 38.5% of the census tracts have a minority population of forty percent or more. These census tracts only received 8.4% of the total housing lending in the SMSA. The census tracts with less than thirty-nine percent minority population account for 61.5% of the SMSA's total number of census tracts. However, they received 91.6% of the SMSA total housing lending.

Fact 5: The lending industry is lobbying Congress hard this year for power to do more financial services than housing loans. The financial regulators under the Reagan Administration are failing to enforce the Community Reinvestment Act, which require lenders to meet the credit needs of all communities. Chicago financial institutions will have to be held accountable by Chicago's neighborhoods if the dollars are to flow differently.

National Training & Information Center
954 W. Washington Blvd., Chicago, Illinois 60607
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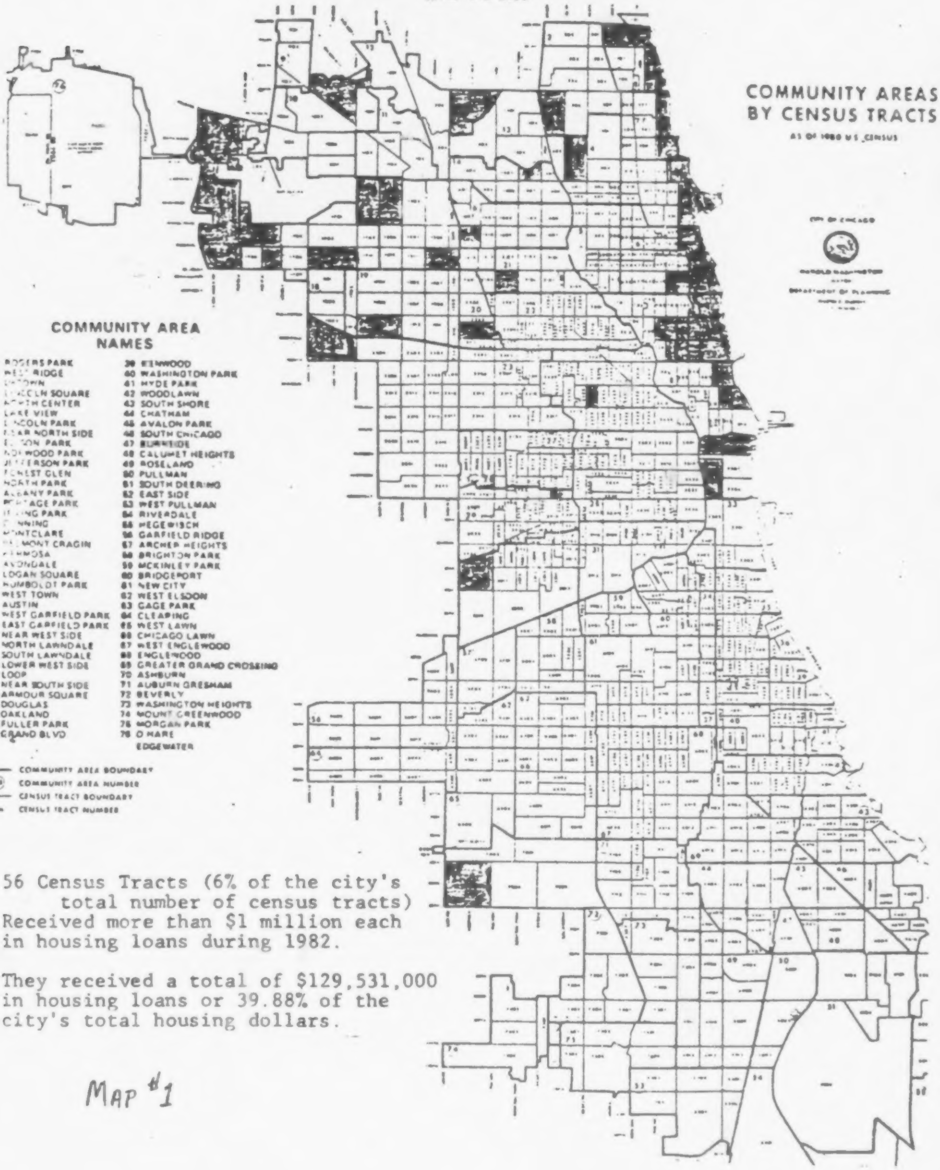
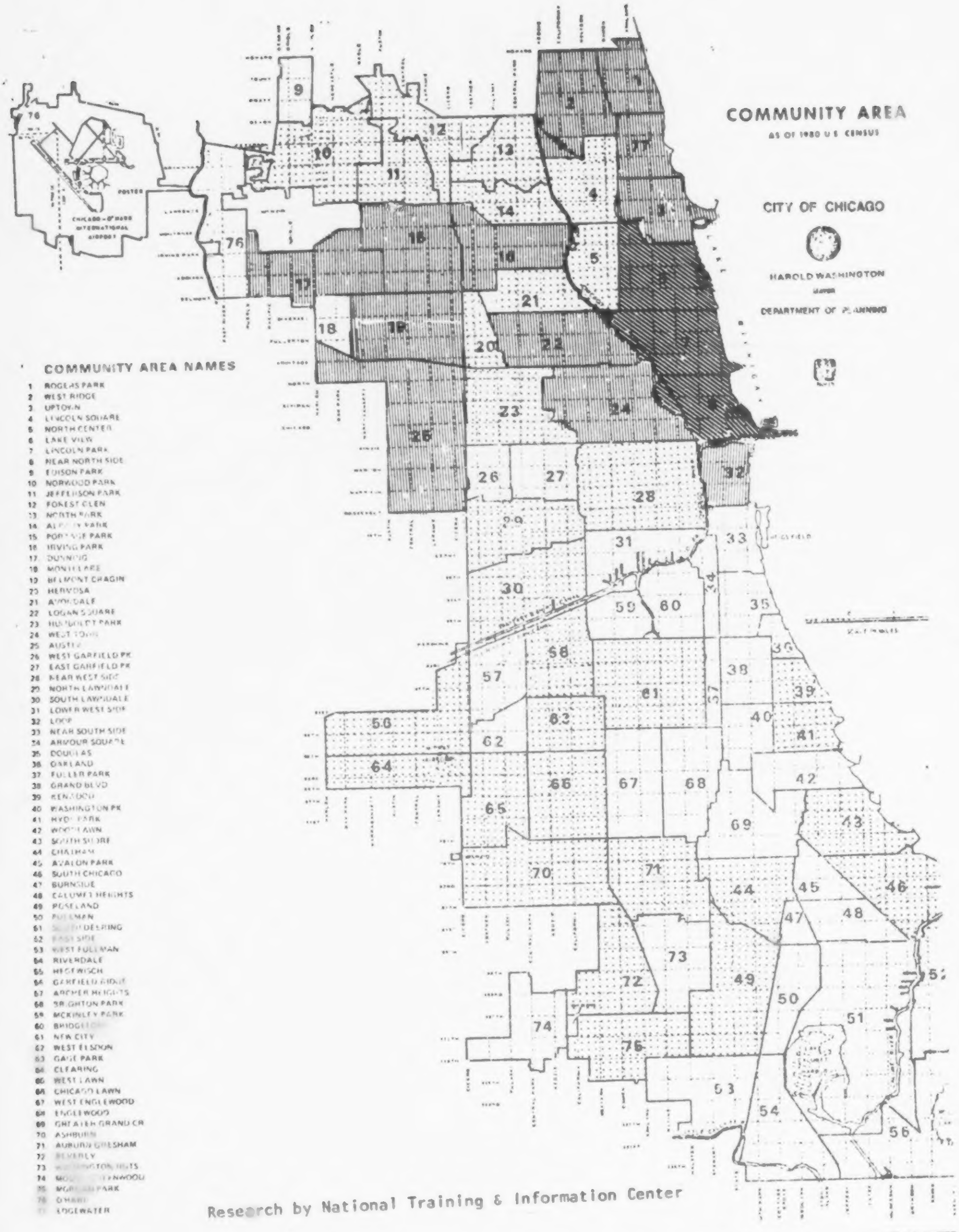

COMMUNITY AREAS
BY CENSUS TRACTS
AS OF 1980 U.S. CENSUS
CITY OF CHICAGO
HAROLD WASHINGTON
MAYOR
DEPARTMENT OF PLANNING
COMMUNITY AREA
NAMES
ROGERS PARK
WEST RIDGE
UPTOWN
LINCOLN SQUARE
NORTH CENTER
LAKE VIEW
LINCOLN PARK
NEAR NORTH SIDE
EDISON PARK
NORWOOD PARK
JEFFERSON PARK
FOREST GLEN
NORTH PARK
ALBANY PARK
PORTAGE PARK
IRVING PARK
DUNNING
MONTCLARE
BELMONT CRAGIN
HERMOSA
AVONDALE
LOGAN SQUARE
HUMBOLDT PARK
WEST TOWN
AUSTIN
WEST GARFIELD PARK
EAST GARFIELD PARK
NEAR WEST SIDE
NORTH LAWNDALE
SOUTH LAWNDALE
LOWER WEST SIDE
LOOP
NEAR SOUTH SIDE
ARMOUR SQUARE
DOUGLAS
OAKLAND
FULLER PARK
GRAND BLVD
39 KENWOOD
40 WASHINGTON PARK
41 HYDE PARK
42 WOODLAWN
43 SOUTH SHORE
44 CHATHAM
45 AVALON PARK
46 SOUTH CHICAGO
47 BURNSIDE
48 CALUMET HEIGHTS
49 ROSELAND
50 PULLMAN
51 SOUTH DEERING
52 EAST SIDE
53 WEST PULLMAN
54 RIVERDALE
55 HEGEWISCH
56 GARFIELD RIDGE
57 ARCHER HEIGHTS
58 BRIGHTON PARK
59 MCKINLEY PARK
60 BRIDGEPORT
61 NEW CITY
62 WEST ELSDON
63 GAGE PARK
64 CLEARING
65 WEST LAWN
66 CHICAGO LAWN
67 WEST ENGLEWOOD
68 ENGLEWOOD
69 GREATER GRAND CROSSING
70 ASHBURN
71 AUBURN GRESHAM
72 BEVERLY
73 WASHINGTON HEIGHTS
74 MOUNT GREENWOOD
75 MORGAN PARK
76 O HARE
EDGEWATER
COMMUNITY AREA BOUNDARY
COMMUNITY AREA NUMBER
CENSUS TRACT BOUNDARY
CENSUS TRACT NUMBER

56 Census Tracts (6% of the city's
total number of census tracts)
Received more than $1 million each
in housing loans during 1982.

They received a total of $129,531,000
in housing loans or 39.88% of the
city's total housing dollars.

MAP #1


COMMUNITY AREA
AS OF 1980 U.S. CENSUS
CITY OF CHICAGO
HAROLD WASHINGTON
MAYOR
DEPARTMENT OF PLANNING
CHICAGO-O'HARE INTERNATIONAL AIRPORT
LAKE MICHIGAN
HOWARD
FOSTER
BELMONT
FULLERTON
NORTH
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COMMUNITY AREA NAMES

1	ROGERS PARK
2	WEST RIDGE
3	UPTOWN
4	LINCOLN SQUARE
5	NORTH CENTER
6	LAKE VIEW
7	LINCOLN PARK
8	NEAR NORTH SIDE
9	EDISON PARK
10	NORWOOD PARK
11	JEFFERSON PARK
12	FOREST GLEN
13	NORTH PARK
14	ALBANY PARK
15	PORTAGE PARK
16	IRVING PARK
17	DUNNING
18	MONTCLARE
19	BELMONT CRAGIN
20	HERMOSA
21	AVONDALE
22	LOGAN SQUARE
23	HUMBOLDT PARK
24	WEST TOWN
25	AUSTIN
26	WEST GARFIELD PK
27	EAST GARFIELD PK
28	NEAR WEST SIDE
29	NORTH LAWNDALE
30	SOUTH LAWNDALE
31	LOWER WEST SIDE
32	LOOP
33	NEAR SOUTH SIDE
34	ARMOUR SQUARE
35	DOUGLAS
36	OAKLAND
37	FULLER PARK
38	GRAND BLVD
39	KENWOOD
40	WASHINGTON PK
41	HYDE PARK
42	WOODLAWN
43	SOUTH SHORE
44	CHATHAM
45	AVALON PARK
46	SOUTH CHICAGO
47	BURNSIDE
48	CALUMET HEIGHTS
49	ROSELAND
50	PULLMAN
51	SOUTH DEERING
52	EAST SIDE
53	WEST PULLMAN
54	RIVERDALE
55	HEGEWISCH
56	GARFIELD RIDGE
57	ARCHER HEIGHTS
58	BRIGHTON PARK
59	MCKINLEY PARK
60	BRIDGEPORT
61	NEW CITY
62	WEST ELSDON
63	GAGE PARK
64	CLEARING
65	WEST LAWN
66	CHICAGO LAWN
67	WEST ENGLEWOOD
68	ENGLEWOOD
69	GREATER GRAND CR
70	ASHBURN
71	AUBURN GRESHAM
72	BEVERLY
73	WASHINGTON HTS
74	MOUNT GREENWOOD
75	MORGAN PARK
76	O'HARE
77	EDGEWATER

Research by National Training & Information Center

1982 Aggregate Home Mortgage Disclosure Act (HMDA) Data

▩	3 Communities each received over $25 million. They received 29% of the city's total housing loans.	⠿	30 Communities each received between $2 million to $6 million. They received 31% of the city's total housing loans.
▥	12 Communities each received between $6 million to $11 million. They received 30% of the city's total housing loans.	☐	32 Communities each received under $2 million to as low as only $172,000. They received only 10% of the city's total housing loans.

Note: No communities received between $25 million to $11 million in housing loans.

MAP #2

Chicago Tribune
25c Monday, February 6, 1984

Area banks' loan policies called unfair

By Stanley Ziemba
Urban affairs writer

AN ORGANIZATION concerned with the plight of inner-city neighborhoods charged Sunday that the money available from area banks and savings and loans for mortgages and home-improvement loans in Chicago is not being distributed evenly throughout the city's neighborhoods.

The group, National Peoples Action, a Chicago-based coalition of some 300 community groups nationwide, has concluded that about 60 percent of the money loaned in 1982 for housing purchases and rehabilitation in the city went to 15 of the city's 77 neighborhoods, and that 32 others received only 10 percent of such loans.

Moreover, the study said that 77 percent of the $1.4 billion loaned for housing in the six-county metropolitan area in 1982 went to the suburbs, even though suburban residents make up only 58 percent of the region's total population. In 1980, the suburbs received 66 percent of the money loaned, the study said.

NPA USED its findings to suggest that the Community Reinvestment Act, a federal law enacted five years ago, had not been effective, at least not in Chicago.

The law, intended to ensure the equal availability of mortgage money to qualified borrowers regardless of where they live, was created in response to charges by neighborhood groups that some lending institutions were engaging in "redlining"—discrimination in granting mortgages and other types of loans in low-income and minority neighborhoods.

While representatives of the area's banking and savings and loan industry did not dispute the study's findings, some termed the report "irresponsible" for implying that lending institutions were deliberately denying loans to some neighborhoods and defying the federal law.

The NPA study determined that of the $324.7 million loaned in 1982 for home purchases and improvements in Chicago, 29 percent was for housing in three lakefront neighborhoods—Lincoln Park, Lake View and the Near North Side.

Each of the three communities, the study said, received more than $25 million in loans.

Another 30 percent of the total loaned in 1982 went to just 12 other communities, all on the city's North Side, the study found. The communities include the Loop, Uptown, Edgewater and Rogers Park, all along the lakefront; West Ridge, on the far North Side; and West Town, Logan Square, Irving Park, Austin, Belmont-Cragin, Dunning and Portage Park, on the Northwest Side.

Each of the 12 received between $6 million and $11 million in loans.

INDUSTRY EXECUTIVES said banks and savings and loans are doing a good job of meeting the credit needs of qualified homeowners and home buyers despite a depressed economy.

"If some areas aren't getting a lot of loans, it's because few people in those areas are applying for them," said Warren Pursell, president of the Illinois League of Savings Institutions.

The NPA's director, Gale Cincotta, said that because individuals were not applying for loans did not mean they were not in need of them.

"It's a question of where the financial insitutions are marketing their loans," she said. "They do a good job of advertising in the suburbs and in some lakefront city neighborhoods that they have loans available, but not in the inner-city."

For More Information,
Contact:

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354 W. Washington
Chicago, IL 60607
(312)243-3038

C.C.N.C.

CONCERNED
CITIZENS OF
NORTH CAMDEN

WHAT WE CAN'T DO ALONE WE CAN DO TOGETHER
Strength in Unity!
TOGETHER

543 STATE STREET
CAMDEN, N.J. 08102
Tel. 966-3360-3351

January 30, 1984

IMMEDIATE RELEASE

From: Concerned Citizens of North Camden

Subject: Community Reinvestment Act

Although the Community Reinvestment Act will be five years old on February 5th, redlining still exists.

Using data provided under the Home Mortgage Disclosure Act available at the Delaware Valley Regional Planning Commission in Philadelphia, CCNC learned that financial institutions still make a disproportionate amount and number of loans to suburban homeowners. Out of $55.6 million loaned to homeowners and housing investors in Camden County, only $1.7 million was loaned within the City of Camden. This is only 3% of the County total, eventhough 13.5 % of the County's homeowners live in the City of Camden.

North Camden, South Camden and Parkside together account for about 3.5% of the County's owner-occupied housing units, equivalent to the proportion found in suburban Haddonfield. $3.8 million (150 loans) was loaned to property owners in Haddonfield; only $0.3 million (31 loans) was loaned in the three Camden neighborhoods combined.

The attached map compares census tracts where 1.5% or less of the owner-occupied houses received loans with those where 3.0% or more received loans. The pattern is clear. Tracts in the former category are concentrated in the City and have ~~a~~ predominantly minority population, while those in the latter category comprise a ring of predominantly white suburbs outside

- more -

TOGETHER WE CAN MAKE A DIFFERENCE— JUNTOS HACEMOS UNA DIFERENCIA!

the City.

CCNC also examined the performance of two major banking institutions based in Camden, the Bank of New Jersey and the Heritage bank. Although the two banks together made 358 loans in Camden County, only two loans were made to the North and South Camden and Parkside neighborhoods combined, both by the Bank of New Jersey. The Heritage Bank made 276 loans in Camden County; none were made in North Camden, South Camden, East Camden or Parkside.

CCNC has conducted this research as part of a nationwide effort sponsored by National Peoples' Action based in Chicago. This campaign is mounted to dispel the myth that redlining no longer exists. In addition, community groups must counter Congressional attempts to further deregulate banks (Senate Bill 2181 sponsored by Jake Garn) and to let the Home Mortgage Disclosure Act expire in 1985. The Community Reinvestment Act cannot be enforced without data available to analyze lending patterns.

For more information, contact Tom Knoche at CCNC, 966-3360, or National Peoples' Action in Chicago at 312-243-3038 (Ted Wysocki or Shel Trapp).

- end -

1982 AGGREGATE HOME MORTGAGE DISCLOSURE ACT DATA - CAMDEN CO.

PART I - CITY/SUBURB COMPARISON

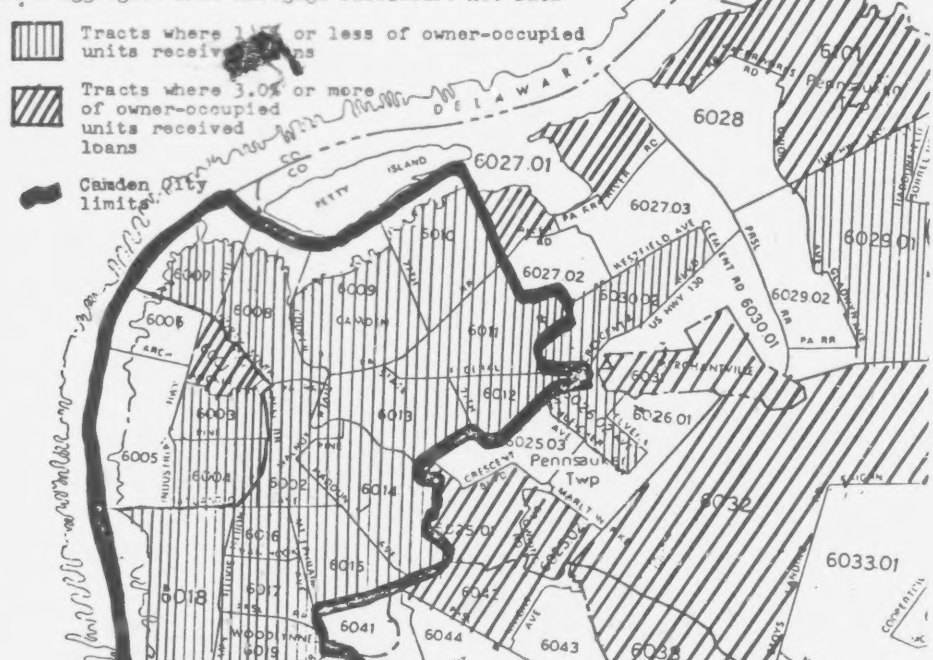
	TOTAL HOME PURCHASE LOANS	TOTAL HOME IMPVT LOANS	TOTAL MORTGAGE LOANS ON MULTI-FAMILY UNITS	TOTAL HOUSING LENDING	% OF CAMDEN CO. TOTAL	# OF HOUSING LOANS	% OF HOUSING LOANS IN CAMDEN CO.	# OF OWNER-OCCUPIED UNITS	% OF OWNER OCCUPIED UNITS IN CAMDEN CO.
CAMDEN CITY	$1,098,000	$630,000	-0-	$1,728,000	3%	204	7%	15,111	13.5%
CAMDEN CO. SUBURBS	$41,452,000	$10,936,000	$1,523,000	$53,911,000	97%	2649	93%	97,417	86.5%
TOTAL CAMDEN COUNTY	$42,550,000	$11,566,000	$1,523,000	$55,639,000	100%	2853	100%	112,588	100%

PART II - NEIGHBORHOOD COMPARISON

	# OWNER-OCCUPIED UNITS	% OF CO. TOTAL OWNER OCCUPIED UNITS	# OF LOANS	% OF LOANS IN CAMDEN CO.	TOTAL HOUSING LENDING $	% OF TOTAL LENDING IN CAMDEN COUNTY
NORTH CAMDEN	929	0.8%	13	0.5%	$27,000	0.4%
SOUTH CAMDEN	1776	1.6%	13	0.5%	$65,000	0.1%
PARKSIDE	1251	1.1%	5	0.2%	$37,000	0.07%
FAIRVIEW	1822	1.6%	39	1.4%	$432,000	0.8%
PENNSAUKEN	9655	8.6%	215	7.5%	$2,358,000	4.2%
CHERRY HILL	5579	5%	188	6.6%	$5,085,000	9.1%
MERCHANTVILLE	958	0.9%	40	1.4%	$751,000	1.3%
HADDONFIELD	3795	3.4%	150	5.3%	$3,808,000	6.8%

Prepared by
Concerned Citizens
of North Camden

1982 Aggregate Home Mortgage Disclosure Act Data



▥ Tracts where 1[illegible] or less of owner-occupied units receiv[illegible]ns

▨ Tracts where 3.0% or more of owner-occupied units received loans

Camden City limits

Prepared by Concerned Citizens of North Camden

DELAWARE
PETTY ISLAND
CAMDEN
Pennsauken Twp
Haddon Twp.
COLLINGSWOOD
HADDONFIELD
MOUNT EPHRAIM
HADDON HEIGHTS
BELLMAWR
LAWNSIDE
BARRINGTON
MAGNOLIA
RUNNEMEDE
GLOUCESTER
WOODLYNNE
PHILADELPHIA
CAMDEN
6101
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**MASSACHUSETTS URBAN REINVESTMENT
ADVISORY GROUP, INC.**
3710 WASHINGTON STREET
BOSTON, MASSACHUSETTS 02130
617-522-2077

Hugh MacCormack
Chairman

Mary O'Hara
Executive Director

OBSERVATIONS ON BOSTON AGGREGATE HOUSING LENDING FOR 1982

Boston represents 28% (160) of the SMSA's 584 census tracts. However, Boston accounted for only 14% ($109 million) of total housing lending in the SMSA ($769 million).

In comparing the number of loans granted, Boston accounted for 13.5% (2,775 loans) of a total 20,492 loans made in the SMSA.

The heart of Boston's residential neighborhoods are low-income (below 80% of the SMSA median family income of $22,800). This area corresponds closely to areas of least investment (see chart of neighborhood lending and accompanying maps).

Several neighborhoods, or selected census tracts within low to moderate-income neighborhoods, did receive considerably more housing credit. High lending in these areas -- Allston, Brighton, parts of Jamaica Plain and the North End/Waterfront -- is a reflection of gentrification and/or condominiumization, and does not reflect a significant increase in lending to the majority of residents of these neigbhorhoods.

While disinvestment is not by any means limited to neighborhoods with high minority populations, these areas are uniformly disinvested. Roxbury, a 17-tract community with an average 91% minority (primarily black) population, had an average investment of $71,353/6 loans per census tract. The adjacent Mission Hill, with the same average family income but only 52% minority population, had an average of $226,750/11 loans per census tract.

However, both of these neighborhoods are vastly underinvested, along with North and South Dorchester, Mattapan, Charlestown, most of the South End, South Boston and East Boston. Other low to moderate-income neighborhoods such as Hyde Park, Roslindale, and much of Jamaica Plain and the South End fare little better.

Beacon Hill, the Back Bay and the Waterfront section of the North End are the city's high income, luxury condominium areas. Combined lending ($32,423,000) for these census tracts represents 30% of total Boston housing lending, although they constitute only 8% of the city's census tracts.

In comparison with SMSA-wide averages, Boston's neighborhoods fare very badly. The SMSA average investment per census tract is $1,323,535/35 loans. The city of Boston's average is $682,206 and 17 loans per tract. Thirteen of Boston's 18 neighborhoods fall below the SMSA dollar investment average, and 15 of the 18 neighborhoods average fewer number of loans per tract than the SMSA as a whole.

On the brighter side, lending in Boston has increased enormously since the enactment of the Home Mortgage Disclosure Act (HMDA). While we do not have aggregate data analysis available for comparison at present, MURAG has monitored lending by Boston's 12 major lenders for the past three years, and lending to all of Boston's neighborhoods has increased dramatically, despite lags in Roxbury and North Dorchester.

Improvements in the economy, the secondary mortgage market and changing perceptions about urban living explain only part of this change. HMDA data has made it possible for MURAG to analyze banks' lending patterns. With this solid statistical evidence in hand, MURAG has been able to successfully negotiate Community Reinvestment Act (CRA) agreements with more than a dozen of Boston's major lending institutions. These agreements have resulted in the direct commitment of tens of millions of housing and commercial credit dollars; the indirect impact on other banks' lending policies and practices has been immeasurable.

If you would like more information on housing lending in Boston, distribution of investment in specific neighborhoods, or other related issues, please contact Mary O'Hara at Mass. Urban Reinvestment Advisory Group (MURAG), 3710 Washington Street, Boston, MA 02130, (617)522-2077.

1982 AGGREGATE HOUSING LENDING – BOSTON SMSA (Home Mortgage Disclosure Data)

Neighborhood	# Tracts	% Minority	% Median SMSA Income	Total Housing Lending	(% of Boston Total)	Total # Loans	(% of Boston Total)	AVERAGE INVESTMENT PER TRACT	
Beacon Hill	3	7%	132%	$ 6,823,000	6%	89	3%	$2,274,333	30 loans
Back Bay	5	12%	129%	$17,168,000	16%	198	7%	$3,489,600	40 loans
West Roxbury	5	3%	100%	$ 5,247,000	5%	168	6%	$1,049,400	34 loans
Hyde Park	5	16%	82%	$ 2,155,000	2%	114	4%	$ 431,000	23 loans
Brighton	5	11%	80%	$ 8,042,000	7%	215	8%	$1,608,400	43 loans
Charlestown	8	3%	80%	$ 1,760,000	2%	50	2%	$ 220,000	6 loans
North End/ Waterfront	5	4%	77%	$ 8,152,000	7%	105	4%	$1,630,400	21 loans
Roslindale	10	10%	75%	$ 4,290,000	4%	173	6%	$ 429,000	17 loans
South Dorchester/ Mattapan	14	55%	71%	$ 4,084,000	4%	250	9%	$ 291,714	18 loans
Jamaica Plain	7	36%	67%	$ 5,256,000	5%	151	5%	$ 750,857	22 loans
Allston	6	18%	64%	$17,168,000	16%	373	13%	$2,861,333	62 loans
South End	12	59%	63%	$ 9,548,000	9%	140	5%	$ 795,660	12 loans
South Boston	14	3%	61%	$ 4,730,000	4%	111	4%	$ 337,857	8 loans
East Boston	12	5%	60%	$ 4,577,000	4%	175	6%	$ 381,417	15 loans
Fenway	4	26%	59%	$ 3,911,000	4%	92	3%	$ 977,750	23 loans
North Dorchester	24	61%	56%	$ 3,842,000	3%	233	8%	$ 160,083	10 loans
Mission Hill	4	52%	46%	$ 907,000	0.8%	43	1%	$ 226,750	11 loans
Roxbury	17	91%	46%	$ 1,213,000	1%	95	3%	$ 71,353	6 loans
TOTAL BOSTON	160			$ 109,153,000	*	2775	*	$ 682,206	17 loans
TOTAL SUBURBS	421			$ 659,821,000		17717		$1,567,271	42 loans
TOTAL SMSA	581			$ 768,974,000		20492		$1,323,535	35 loans

* Percentages have been rounded off and do not add up to 100% of total.

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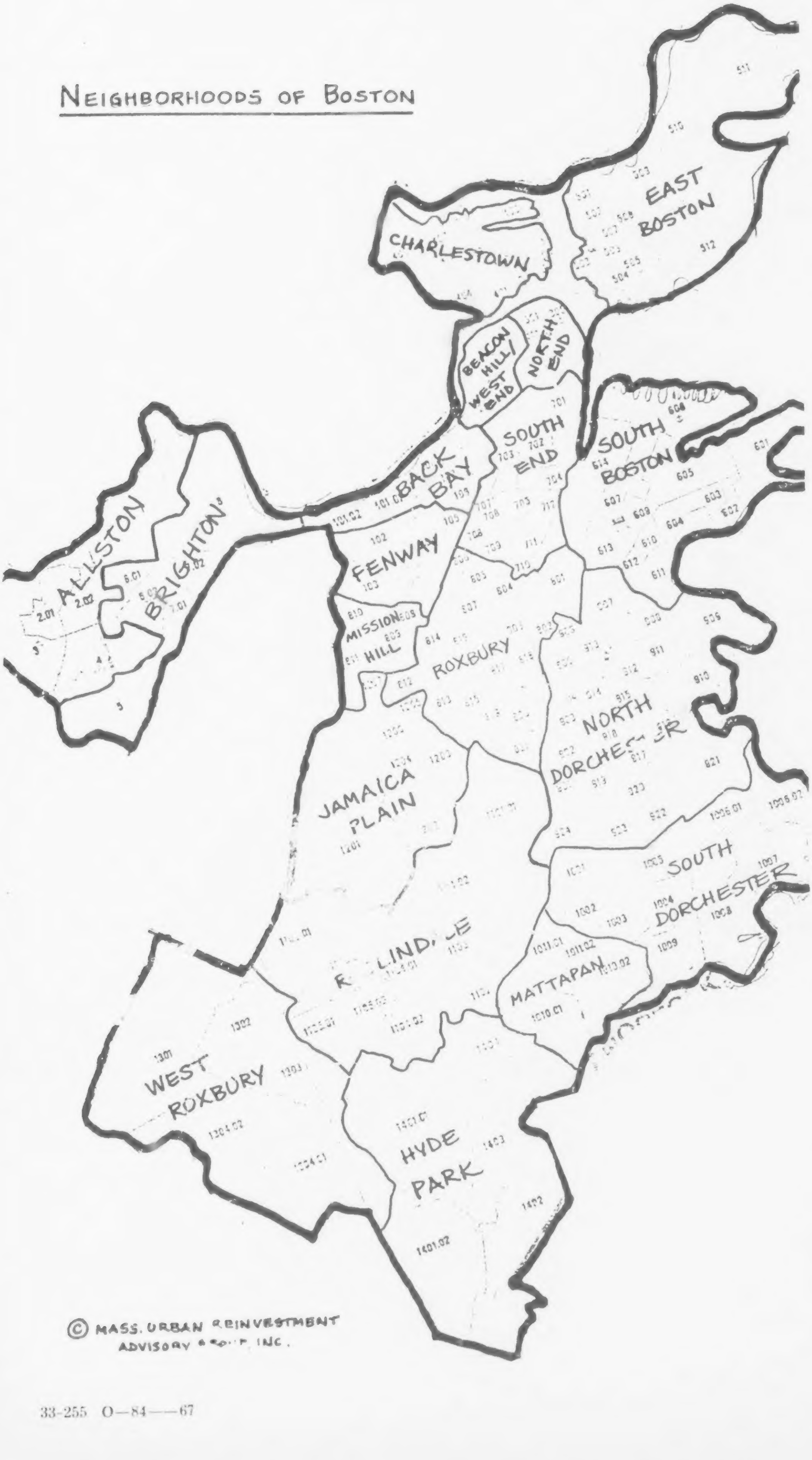
NEIGHBORHOODS OF BOSTON


EAST BOSTON
CHARLESTOWN
BEACON HILL/ WEST END
NORTH END
SOUTH END
BACK BAY
SOUTH BOSTON
ALLSTON
BRIGHTON
FENWAY
MISSION HILL
ROXBURY
NORTH DORCHESTER
JAMAICA PLAIN
SOUTH DORCHESTER
ROSLINDALE
MATTAPAN
WEST ROXBURY
HYDE PARK

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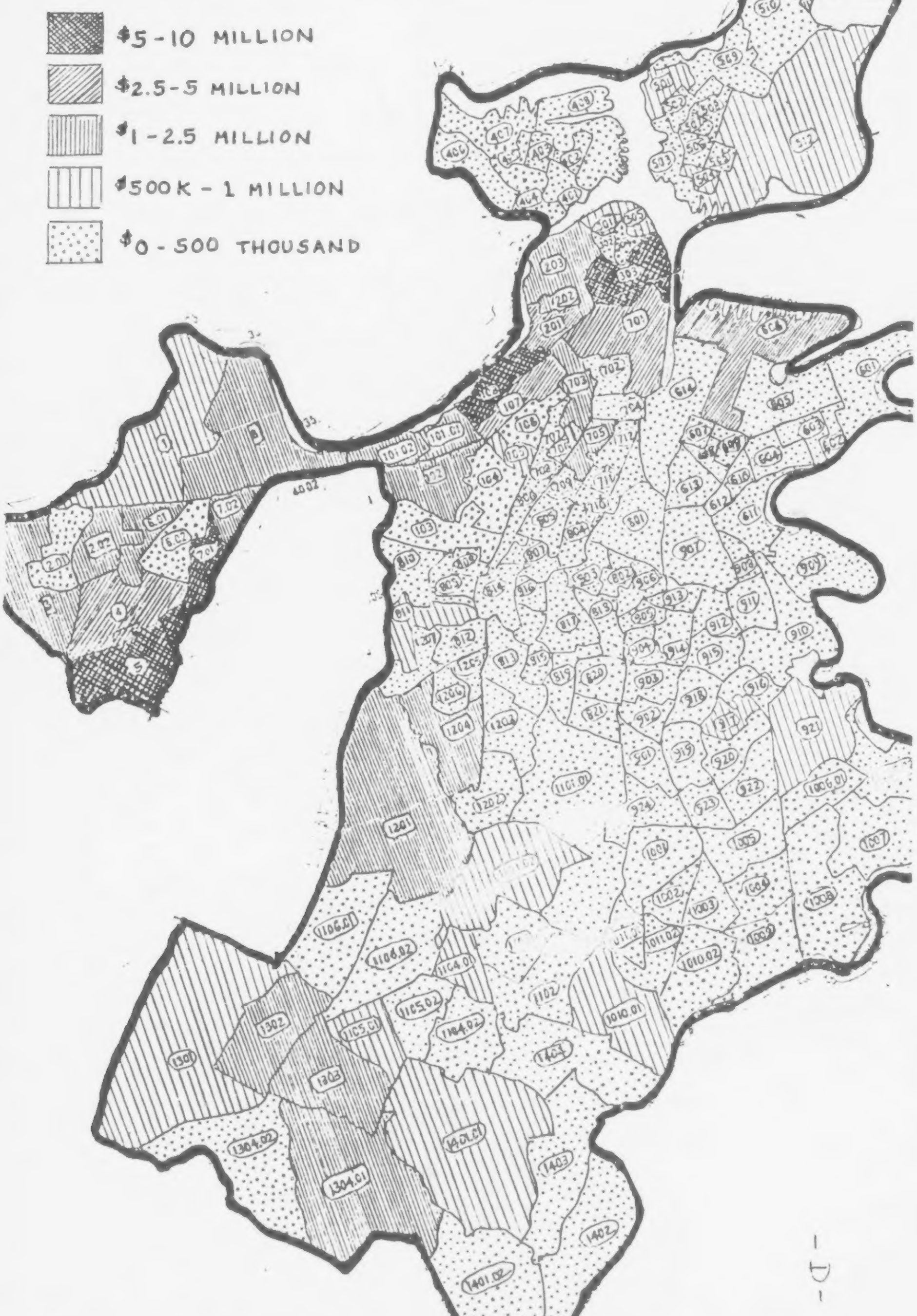
CITY OF BOSTON
1982 AGGREGATE HOUSING LENDING


▩ $5-10 MILLION
▨ $2.5-5 MILLION
▥ $1-2.5 MILLION
▥ $500K - 1 MILLION
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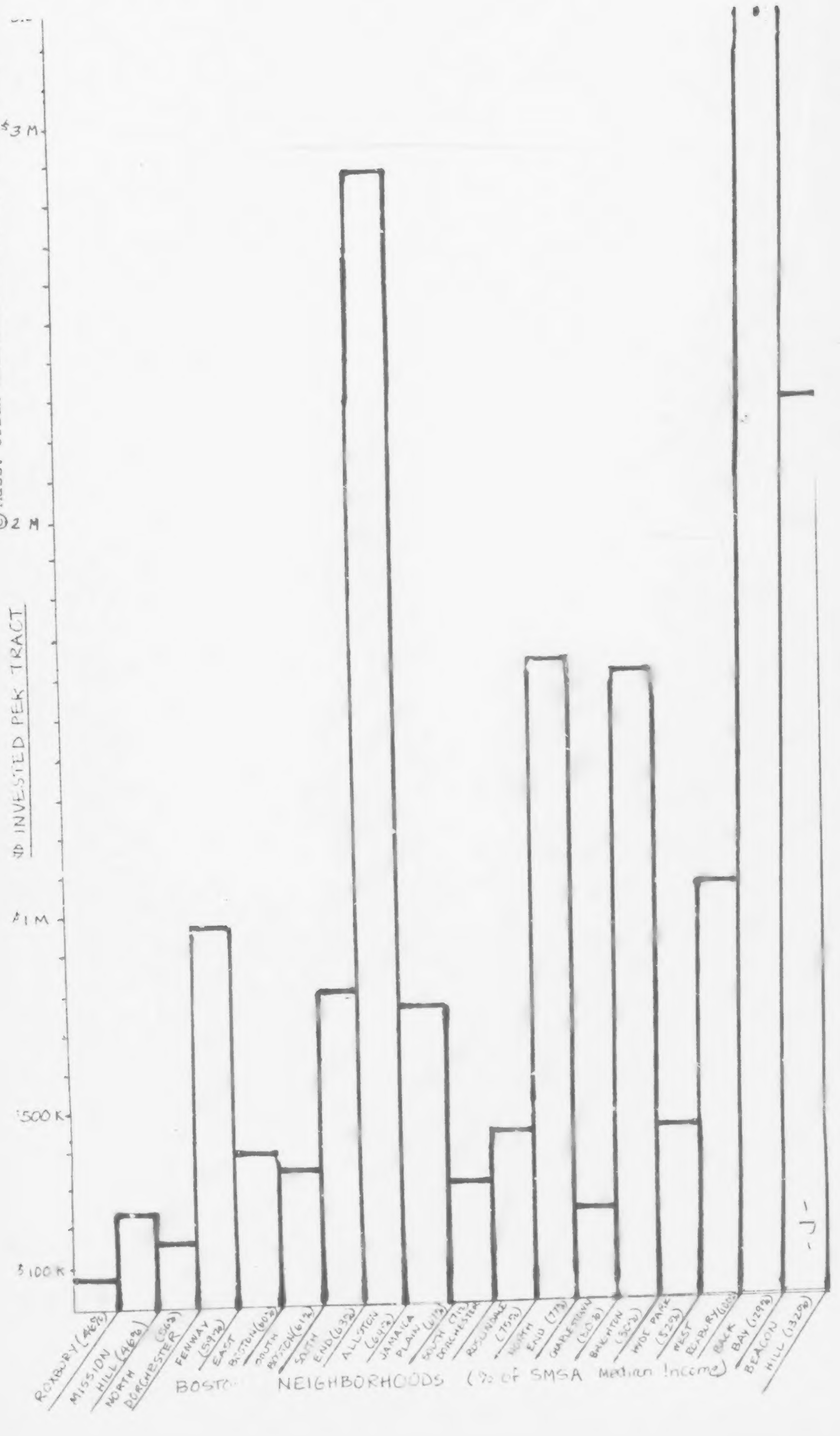

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THIS IS THE TOTAL NUMBER OF
MORTGAGES AND IMPROVEMENT LOANS
SOLD THROUGH ALL BANKS IN 1982

Syracuse United Neighbors
1515 Midland Ave.
476-7475

CITY LOWER-INCOME
NEIGHBORHOODS

1982

Home Mortgage Disclosure Act Aggregate

City of Syracuse

Census Tract	Area	Total Home Purchase Loans		Total Home Improvement Loans	
		# of Loans	Amount	# of Loans	Amount
NEAR WESTSIDE					
30	Fayette to Gifford S. Geddes to S. West	1	10,000	10	42,000
38	Grand to Bellevue Geddes to Velasko Rd. (Skunk City)	3	52,000	10	48,000
39	Merriman to Bellevue S. Geddes to S. West	5	73,000	16	98,000
40	Seymour to Merriman S. Geddes to S. West	1	12,000	2	12,000
SOUTWEST					
52	Tallman to Crescent Onondaga Ave. to Onondaga Creek	0	0	17	82,000
SOUTHSIDE					
53	Raynor to McLennan Cortland/Midland to Route 81	2	31,000	20	88,000
54	McLennan to W. Brighton Midland to Route 81	2	30,000	43	136,000
58	Kennedy to Matson Onondaga Crk. to Midland	2	39,000	44	160,000
59	Brignton to Matson Midland to Route 81	6	76,000	21	82,000
Average of the Above 9 Census Tracts:		2.4	35,800	20.3	83,111

THIS IS THE TOTAL NUMBER OF
MORTGAGES AND IMPROVEMENT LOANS
SOLD THROUGH ALL BANKS IN 1982

Syracuse United Neighbors
1515 Midland Ave.
476-7475

CITY UPPER-INCOME
NEIGHBORHOODS

1982

Home Mortgage Disclosure Act Aggregate

City of Syracuse

Census Tract	Area	Total Home Purchase Loans		Total Home Improvement Loans	
		# of Loans	Amount	# of Loans	Amount
NORTHEAST					
9	Grant Blvd. to James St. Dewitt St. to Grant Blvd.	15	717,000	21	101,000
17.01	James to Burnet St. Elm to Teall	10	495,000	7	40,000
19	James to Burnet Midler to Thompson	20	564,000	28	185,000
UPPER EASTSIDE					
10	Grant Blvd. to E. Lamson Dunlop to James St.	7	235,000	20	88,000
17.02	Teall to Hickok James to Burnet	9	272,000	24	153,000
18	Hickok to Midler James to Burnet	4	107,000	14	93,000
Average of above 6 Census Tracts:		10.8	398,333	19	110,000

THIS IS THE TOTAL NUMBER OF
MORTGAGES AND IMPROVEMENT LOANS
SOLD THROUGH ALL BANKS IN 1982

Syracuse United Neighbors
1515 Midland Ave.
476-7475

SUBURBS UPPER-INCOME
NEIGHBORHOODS

1982

Home Mortgage Disclosure Act Aggregate

City Of Syracuse

Census Tract	Area	Total Home Purchase Loans # of Loans	Total Home Purchase Loans Amount	Total Home Improvement Loans # of Loans	Total Home Improvement Loans Amount
112.01	N. Syracuse	34	1,263,000	12	62,000
112.03	N. Syracuse	44	1,710,000	19	103,000
113	N. Syracuse	33	1,347,000	93	400,000
151	Manlius	29	1,526,000	17	148,000
152.01	Manlius	28	1,641,000	25	166,000
152.02	Manlius	22	1,217,000	21	134,000
Average of the above 6 Census Tracts:		31.6	1,450,000	31.2	168,833

Syracuse United Neighbors
1515 Midland Ave., Syr., N.Y.
476-7475

HOME MORTGAGE DISCLOSURE ACT (HMDA) DATA 1982 AGGREGATE Syracuse SMSA

() - No. of Loans

	Total Home Purchase Loans (1-4 units)	Total Home Improvement Loans (1-4 units)	Total Mortgage Loans on Multi-Family Dwellings	Non-Occupant Loans (1-4 units)	Total Housing Lending (sum of first 3 columns)	Total Lending as a Percentage of SMSA Total Lending
City	9,295,000 (301)	4,101,000 (858)	305,000 (2)	132,000	13,701,000 (1161)	15%
Onondaga County (doesn't incl. city)	41,645,000 (1077)	9,080,000 (1769)	2,662,000 (6)	400,000	53,387,000 (2852)	59%
TOTAL SMSA (Onondaga, Oswego, Madison counties)	66,877,000 (1980)	19,954,000 (3988)	3,163,000 (11)	1,262,000	89,994,000 (5979)	100%

Comparison of 2 Heavily Invested City Neighborhoods with 2 Low and Moderate Income City Neighborhoods and 2 Heavily Invested Neighborhoods in the Suburbs.

Census Tracts		Total Housing Lending (sum of 3 types of loans)	# of Census Tracts Reported	Total Lending as a percentage of SMSA Total Lending	Total Lending Ratio per Census Tract	Home Purchase Loans (1-4 units) # of Loans	$
9,10,17.01 17.02,18,19	Sedgewick & Eastwood	3,050,000	6	3.4%	508,333	65	2,390,000
30,38,39,40, 52,53,54,58, 59	South & Near West	1,071,000	9	1.2%	119,000	22	323,000
112.01,112.03, 113,151,152.01, 152.02	N. Syracuse & Manlius	9,717,000	6	10.8%	1,619,500	190	8,731,000

Syracuse United Neighbors
1515 Midland Ave., N.Y.
476-7475

HOME MORTGAGE DISCLOSURE ACT (HMDA) DATA 1981 AGGREGATE Syracuse SMSA

	Total Home Purchase Loans (1-4 units)	Total Home Improvement Loans (1-4 units)	Total Mortgage Loans on Multi-Family Dwellings	Non-Occupant Loans (1-4 units)	Total Housing Lending (sum of previous 3 columns)	Total Lending as a percentage of SMSA Total Lending
City	$ 12,924,000	3,889,000	1,105,000	94,000	18,012,000	18.5%
Onondaga County (doesn't inc. city)	59,194,000	8,703,000	533,000	574,000	68,430,000	70.6%
TOTAL SMSA	78,459,000	16,613,000	1,789,000	1,393,000	96,861,000	100%

Comparison of 2 Heavily Invested City Neighborhoods with 2 Low and Moderate Income City Neighborhoods

Census Tracts		Total Housing Lending (sum of 3 types of loans)	# of Census Tract Reported	Total Lending as a percentage of City Total Lending	Total Lending Ratio per Census Tract	Home Purchase Loans (1-4 units) # of Loans	$
36.01 36.02 46	Upper Eastside (Erie, Westmoreland Bradford to City line)	3,026,000	3	16.7%	1,008,666	75	2,520,000
10,18, 19	Eastwood	1,274,000	3	7%	424,666	36	1,016,000
30,38,39, 40	Near Westside	305,000	4	1.6%	76,250	6	123,000
52,53,54, 58,59	Near Southside	753,000	5	4.1%	150,600	27	386,000

2/14/84
/sp

610 13th St.
[redacted]
Sioux City, Iowa 51105
(712) 258-3244

COALITION FOR COMMUNITY REFORM

Preliminary Analysis of 1981 & 1982 HMDA Data

Sioux City, Iowa

1.) The CCR census tracts include 1, 6, 8, 12, 13, 14, 15 & 16. All other areas in Sioux City are non-CCR census tracts. The CCR tracts account for 32% of the City's total population and approximately 37% of the City's total housing units. According to 1980 census data, Sioux City has a total population of 82,003 and about 32,000 total housing units.

2.) In 1981, 785 housing loans totalling $16,292,000 were made in Sioux City. The CCR census tracts received 202 loans totalling $2,733,000. In other words, the CCR tracts received about 26% of the housing loans and approximately 17% of the money which was lent. By comparison, the non-CCR tracts received 583 loans (74% of the total) totalling $13,559,000 (83% of the total dollars lent).

3.) In 1982, 693 housing loans totalling $12,180,000 were made in Sioux City. The CCR census tracts received 138 loans (20% of the total) totalling $1,508,000 (12% of the dollars lent). The non-CCR tracts received 555 loans (80% of the total) totalling $10,672,000 (88% of the total dollars lent).

4.) Although CCR census tracts account for about 37% of the City's total housing units, they received 26% of 1981's housing loans and 20% of 1982's housing loans. The non-CCR census tracts received 74% of 1981's housing loans and 80% of 1982's housing loans.

1981 Aggregate HMDA Data

CCR Census Tracts

Tract(#)	Loans	Amounts (000's)
1	40	427
6	15	166
8	37	549
12	24	388
13	13	178
14	38	394
15	30	502
16	5	129
TOTALS	202	2,733

Non-CCR Census Tracts

Tract(#)	Loans	Amounts (000's)
2	39	836
3	89	2,715
4	71	2,447
5	23	266
7	28	379
9	28	653
10	12	87
11	29	467
18	56	857
19	39	593
20	46	656
21.01	65	2,044
21.02	58	1,559
TOTALS	583	13,559

Total Housing Loans - 785

Total $$ Lent - $16,292,000

1982 Aggregate HMDA Data

CCR Census Tracts

Tract(#)	Loans	Amounts (000's)
1	23	158
6	16	134
8	35	512
12	8	84
13	7	154
14	31	306
15	14	143
16	4	17
TOTALS	138	1,508

Non-CCR Census Tracts

Tract(#)	Loans	Amounts (000's)
2	50	784
3	101	2,649
4	58	1,535
5	28	283
7	16	194
9	36	690
10	15	206
11	41	539
18	44	424
19	30	312
20	39	584
21.01	51	1,496
21.02	46	976
TOTALS	555	10,672

Total Housing Loans - 693

Total $$ Lent - $12,180,000

City of Gary
Human Relations Commission
475 BROADWAY · SUITE 108
GARY, INDIANA 46402
944 6541

RICHARD GORDON HATCHER
MAYOR

JOHN MOOREHEAD
CHAIRMAN

CLAUDIA M. NICHOLS
EXECUTIVE DIRECTOR

MARCH 1983

ANALYSIS OF HOME MORTGAGE DISCLOSURE ACT AGGREGATION

TABLES, 1981, and 1980 CENSUS DEMOGRAPHIS INFORMATION

The Home Mortgage Disclosure Act (HMDA) of 1975 and the Community Reinvestment Act (CRA), Title VIII of the Housing and Community Development Act of 1977 are based on a congressional finding that federally regulated financial institutions have a continuing and affirmative obligation to help meet the credit needs of their entire communities including low and moderate income neighborhoods--consistent with safe and sound operation of the institution.

HMDA directs financial institutions to provide disclosure information about residential lending activities in order that the public and the regulatory agencies supervising them can assess their record in meeting the needs of their entire community.

Each institution is required to adopt and make public a CRA statement of how it intends to meet the credit needs of the community. The public is encouraged to make comments both to the institutions and their regulatory agency as to how well it appears to be fulfilling obligations under the Acts.

In 1980 Congress directed HMDA information be "aggregated" by the Federal Financial Institutions Examination Council (FFIEC) for the years 1980 forward. The information is to be completed by December 31 of each succeeding year (1980 was published on December 31, 1981; 1981 information was completed December 31, 1982). "Aggregation" is by Standard Metropolitan Statistical Area (SMSA) and census tract covering all loan originations and purchases by local federally regulated financial institutions within the SMSA. The aggregation tables and the HMDA disclosure statements for each institution in the East Chicago, Gary and Hammond SMSA (Lake and Porter counties) are available at the Gary Public Library which has been designated as the local depository.

Because the aggregation for 1980 uses 1970 census tracts and the one for 1981 uses 1980 census tracts, it would take extensive manipulation to do an analysis of both. By using 1980 census information and the 1981 aggregation tables however, some general conclusion about loan activity in the SMSA by local institutions can be made.

INVESTMENT IN THE CENTRAL CITIES

Table V of the FFIEC report shows that 17% of the total investment went to the central cities of East Chicago, Hammond and Gary. The population of the SMSA splits almost equally between central cities and non-central city areas with 330,380 residing in the cities and 302,987 residing in the non-city area.

This information by itself is not sufficient to draw a conclusion. Adding the racial/national origin information from the 1980 census, does however, indicate a serious lack of loan opportunities for minorities. Almost all minority persons reside in the three cities: 85% of the Black population in Gary, 45% of the Hispanic population in East Chicago.

Table II of the FFIEC report aggregates the HMDA data by income categories. By breaking out minority status/income category figures further conclusions can be made.

INVESTMENT IN MIDDLE INCOME CENSUS TRACTS

The SMSA is comprised of 119 census tracts of which 76 are designated "middle income". ($19,200 to $28,800). The largest portion of local investment covered by HMDA requirements is made in these tracts (3/4ths or 75%).

The accompanying chart illustrates an analysis of that investment by minority population. Almost all of the investment—91.7%-is invested in the 51 tracts consisting of 15% or less minority individuals. These 51 tracts account for 47% of the population of the SMSA (69% of the individuals living in the middle income tracts). The remaining 8.3% of the investment is divided among two categories of increasing minority representation: 1.7% of the money coming to middle income tracts was loaned in those three tracts which are 16-39% minority, making up 4.2% of the middle income population. The rest, 6.54%, went to the 22 tracts which are identified as 40-100% minority and contain 25.6% of the middle income population. Residing in these 22 tracts are 42% of the total minority population of the SMSA.

Sixteen of the minority-middle income tracts are within Gary. With 21% of the middle income population, these 16 tracts received only 3.7% of the investment. When analyzed on an SMSA basis, Gary's middle income tracts represent 14% of the population but received only 2.8% of the total investment. The Gary middle income tracts contain one third of the minority residents of the SMSA.

Close to half (45%) of the minority population of the SMSA live in the 25 middle income tracts which received only 6.1% of the residential investments made by local financial institutions.

LOW TO MODERATE INCOME TRACTS

There are 29 tracts designated low to moderate income. Of the total SMSA investment of $103,583,000, these tracts received $4,093,000, about 4%. Four of these tracts are 15% or less minority, the other 25 are 40-100% minority, all but two being within the cities of East Chicago, Hammond and Gary.

UPPER INCOME TRACTS

There are 11 tracts designated "upper income" (120 percent or more of the SMSA median income of $24,000). None of these tracts are within the central cities. They received approximately 21% of the total investments in residential loans by local financial institutions.

CONCLUSION

It would appear, from this data that the financial institutions in the Lake and Porter area could be taking more positive action to meet not only the credit needs of the low to moderate neighborhoods, but also meet the credit needs of those middle income neighborhoods with significant minority populations.

Indeed, it would appear that by exercising a minority and/or central city marketing effort, financial institutions could increase investment possibilities at least two-fold. By breaking out the HMDA data according to income/minority indicators, the analysis shows that increased investment activity in the middle income minority areas would be consistent with safe and sound operation as required.

Attachment for general distribution: Table A

GARY HUMAN RELATIONS COMMISSION HMDA SUMMARY MARCH 19

TABLE A

Investment in Home Loans, Home Improvement Loans & Multi-Family Units by Federally Regulated Lake and Porter County Financial Institutions 1981

LAKE AND PORTER COUNTIES EAST CHICAGO, GARY, HAMMOND SMSA

MIDDLE INCOME CATEGORY (80% to 120% of median income $24,000)

CENSUS DESIGNATION	POPULATION	AS % OF SMSA	AS % OF MIDDLE INCOME	INVESTMENT	AS % OF SMSA	AS % OF MIDDLE INCOME
Total SMSA (119 Tracts)	633,367			$105,583,000		
Middle Income (76 Tracts)	428,856	67.7%		$80,023,000	75.79%	
15% or Less Minority Middle Income (51 Tracts)	299,315	47%	69.7%	$73,603,000	69.5%	91.7%
16-39% Minority Middle Income (3 Tracts) (3,964 Minority individuals 3% of total minority population)	18,171	28%	4.2%	$1,378,000	1.3%	1.72%
40-100% Minority Middle Income outside Gary (6 Tracts) (18,220 Minority individuals 10% of minority population)	19,889	2%	4.6%	$2,213,000	2%	2.76%
40-100% Minority Middle Income within Gary (16 Tracts) (57,679 Minority individuals 32% of minority population)	91,481	14%	21%	$3,029,000	2.8%	3.78%

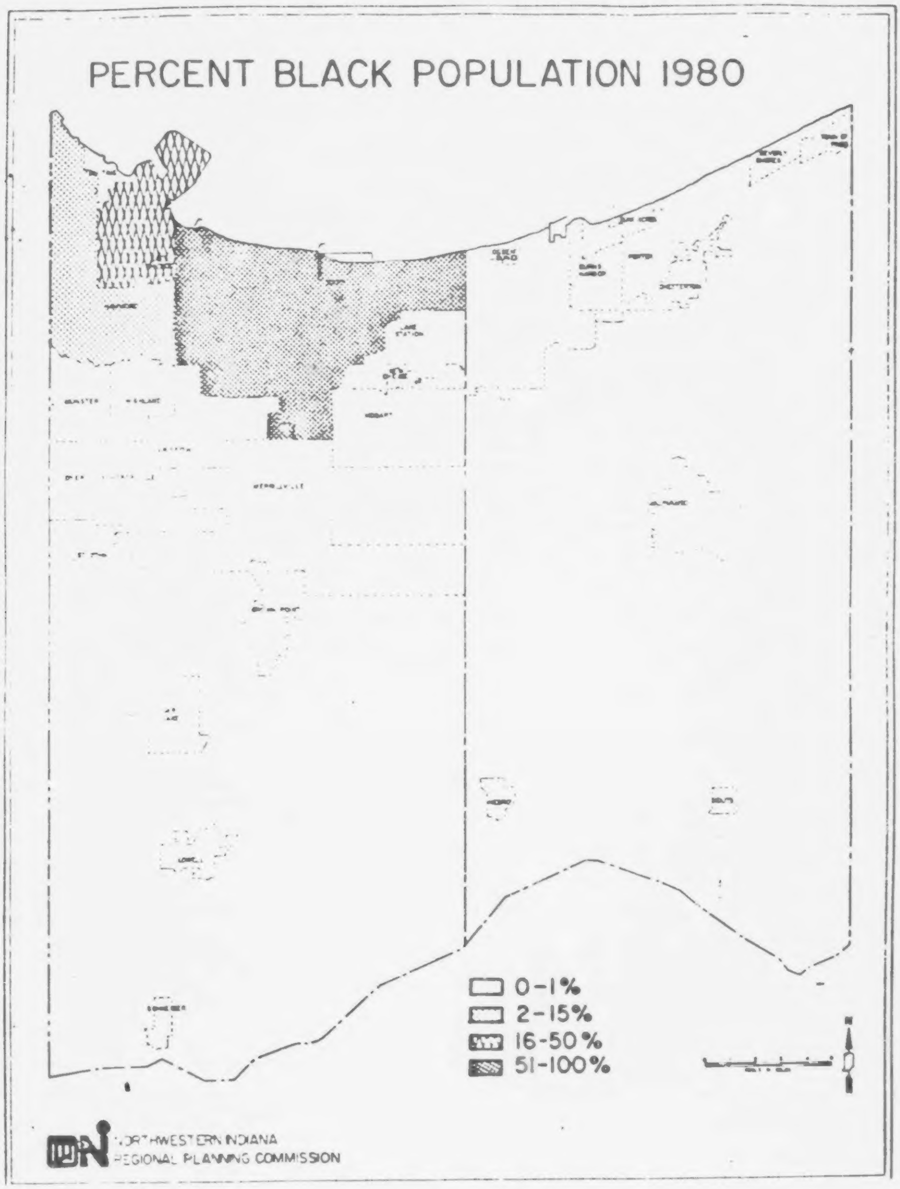
SUMMARY OF LOAN ACTIVITY - 1981, 1982

HOME LOAN ACTIVITY OF FINANCIAL INSTITUTIONS LOCATED IN SMSA;

1981	Population	1981 Home Loan Activity	1982 Home Loan Activity
Central City	285,453	$ 18,139,000	$ 16,560,000
SMSA less Central City	357,328	87,444,000	81,501,000

(Source: Federal Financial Institution Examination Council)

GARY HUMAN RELATIONS COMMISSION
475 Broadway
Rooms: 108-109 & 110
Gary, Indiana 46402



PERCENT BLACK POPULATION 1980

▭ 0-1%
▭ 2-15%
▨ 16-50%
▨ 51-100%

NORTHWESTERN INDIANA
REGIONAL PLANNING COMMISSION

The CHAIRMAN. Thank you, Gale.
Ms. Wilson.

STATEMENT OF PAULINE WILSON, CHAIRPERSON, COALITION AGAINST REDLINING

Ms. WILSON. Thank you, Mr. Chairman.
[The complete statement follows:]

COALITION
AGAINST
REDLINING 198 BROADWAY • ROOM 1100 • NEW YORK, NEW YORK 10038 • (212) 964-7200

My name is Pauline Wilson, Chairperson of the Coalition Against Redlining (CAR). CAR, a New York City-based umbrella group established in 1978, is composed of more than 25 local community organizations in low- and moderate-income communities. We work to ensure that our neighborhoods and our residents have equal access to bank credit and deposit services.

During the 1970's community organizations began documentation of bank disinvestment in their neighborhoods. As a result of our work, the term "redlining" received national prominence and legislation was passed on the local, state and national levels in attempt to deal with this problem. At that time, redlining refered to a practice of banks and insurance companies drawing a red line around urban neighborhoods where loans would not be granted or policies issued.

Today, in the era of "deregulation," redlining has been redefined to mean a denial of equal and affordable access to basic banking services--including deposit as well as credit needs. In many of the areas CAR represents, particularly in the Bronx and Brooklyn, deregulation and redlining are currently synonymous with branch closings. During a four-month period of 1983, Citibank closed five branches in Brooklyn and one in Staten Island. Manufacturers Hanover Trust Company is planning to close twenty-five branches by the end of 1984. Based on preliminary research of FDIC statistics, ten percent of New York State's bank branches ceased operation in 1983. This represents an eighty percent increase in closings since 1977. These closings are serious problem for the neighborhoods concerned and all indications are that this is "just the beginning."

Local communities are searching for ways to ensure that deregulation will not cut off the flow of credit to their areas in favor of more lucrative investments. There is a sound basis for these concerns. First, the high cost of deposits will result in a push to maximize profits which will work to the disadvantage of sound, but less lucrative community credit needs. As small financial institutions are acquired by larger and more aggressive banks, decisions affecting community credit needs will be made in board rooms of nationwide concerns. The expansion of deposit bases will make CRA evaluation more difficult and in turn will result in less leverage for local residents. The increased powers of the savings and loan industry could alter their role as mortgage lenders and result in a reduction of mortgage funds.

In its report to Governor Cuomo, the New York State Temporary Commission on Banking, Insurance and Financial Services attempted to respond to community concerns about deregulation. The Commission recommended:

+ the establishment of a Superviory Procedure to deal with branch closings:
+ development of a comprehensive strategy that could replace branches in low and moderate income communities with new community-oriented institutions that would provide basic banking services;
+ establishement of a life-line bank account;
+ amendment of Regulation G-107 (New York State's equivalent to the Home Mortgage Disclosure Act) to require reporting by banks of small business lending;
+ a requirement that mortgage bankers report their mortgage and home improvement lending in a form comparable to Regulation G-107;
+ expansion of the secondary market for small business loans originated by State-Chartered banks;
+ and the use of the State's Retirement Fund and State-chartered banks to establish a deposit/lending program to increase the availability of long-term fixed rates to small businesses.

In the cover letter to this report, Chairman Adrian W. DeWind, Senior Partner of Paul, Weiss, Rifkind, Wharton & Garrison, addressed the necessity of dealing with community concerns: "Government has an affirmative obligation to address these problems and cannot simply write them off as the inevitable by-products of competitive markets." A copy of the Commission's proposals are being submitted along with my testimony.

Before I go on further in my testimony, I want to make it clear that CAR is not opposed to changes within the financial services industry. Indeed we recognize that some change is necessary. However, the financial services industry must demonstrate the need for these wholesale changes and that the changes are good for more than the financial services industry. An article in the New York Times on December 5, 1983 listed the "winners" and the "losers" resulting from the current deregulation. To no one's surprise, small businesses, low-balance depositers, poor people and homebuyers were listed among the "losers." We will not be losers. Our communities will not be losers. We will not sit back and be treated as losers.

On January 28, 1984 I attended a Conference in New York City entitled "Financial Services in the 80's." Sponsored by the Regional Interagency Committee (representatives of the federal bank regulators, the New York State Banking Department and the New Jersey Banking Department), the conference was a response to community fears about banking deregulation. Unfortunately, the conference did nothing to allay fears. In fact, it confirmed our fears. I learned a valuable lesson that day and it can be summed up in one phrase: "Banking is for the rich and not for the poor". I asked a banker whether I should go back to my community and tell them that "poor people don't matter." He responded, "I thought you always knew that."

It is alarming that policy-makers seem unconcerned about the effects of deregulation on urban neighborhoods. One example of this legislative disregard is the Financial Services Competitive Act or S. 2181. If passed into law, S. 2181 would allow bank and thrift holding companies to engage, either directly or through a subsidary, in insurance underwriting and brokerage; real estate development and brokerage; sponsoring and managing investment companies; and other activities determined by the Federal Reserve Board to be of a financial nature.

The proposed law would give permission to enter these fields based on the following criteria: managerial resources; adequacy of financial resources; practices that may adversely affect independence or impartiality in the provision of credit or may adversely affect the terms or the availability of credit; and any adverse effect on the bank's safety and soundness. No mention is made of community reinvestment activities.

Failure of S.2181 to consider community credit needs is in complete disregard of the Community Reinvestment Act which was passed because of the disinvestment in urban neighborhoods. The passage of CRA acknowledged that the operation of a free market did not provide for the credit needs of our urban communities. That acknowledgement occurred in a period of bank regulation, and must continue during this period of deregualtion.

If new powers and new areas of profit are permitted through deregulation, expanded responsibility in the area of community banking and credit needs must be increased; not decreased or ignored. In a February 19, 1984 article in the New York Times, William Isaac, Chairperson of the Federal Deposit Insurance Corporation, was quoted as saying, "There is always going to be a fair amount of Government involvement in banking compared with any other business because banking is so central to the working of the economy." Let me take this opportunity to remind Mr. Isaac, the other bank regulators, banks, and members of the United State Congress that the communities represented today by the Coalition Against Redlining and National Peoples Action are also central to the working of the economy.

There has been very little serious debate on the effects of deregulation on local economies. I should not have to remind you that the health of urban neighborhoods affects the health of the nation as a whole. CAR wants to remind this Committee that grassroot organizations are not the only ones concerned about the current deregulation debate. Paul Volcker, Chairperson of the Federal Reserve System, and Henry Kaufman, economist and managing director of Salomon Brothers, have expressed concern over the piecemeal approach to deregulation before a blueprint for change has been established. (New York Times February 19, 1984)

The prevalent opinion is that Congress will adopt some form of financial reform legislation in 1984. With that in mind, the Coalition Against Redlining makes the following recommendations:

1. Bank entrance into any new financial service must be subject to CRA review and challenge
2. Payment of interest on reserves by the Federal Reserve should be limited to banks with a CRA rating of 1 and who agree to relend 50% of the interest they receive in loans to non-profit community groups and small businesses in distressed areas.
3. Prior to paying any interest, the Federal Reserve should be required to disclose all information relative to an institution's compliance with CRA.
4. Public disclosure of the loans made by the interest payments so that the program could be monitored.
5. Procedures must be established to ensure that the savings and loan association industry retains its committment to housing financing.
6. CRA must amended to call for a review of an institution's practice of closing branches.
7. Regulation must apply to all the new financial actors in their provision of banking services.

In conclusion, let me give you some statistics from a report entitled, "Mortgage Lending in New York City - 1981":

1. Only 18.6% of the mortgage financing for multi-unit housing was provided by commercial banks and thrifts.

2. Commercial banks and thrifts outranked other financial institutions (mortgage funding companies and credit unions) in only one category - condos.

3, Banks and thrifts accounted for only 33.5% of the mortgage lending in New York City compared to 53.3% in Nassau County and 48.6% in Westchester County.

4. Banks and thrifts accounted for only 15.3% of the industrial mortgage market; 16.6% of the retail commercial mortgage market; and 40.7% of the office commercial mortgage market.

A copy of this report is enclosed with my testimony.

Urban neighborhoods still have unmet credit needs and are currently losing access to deposit services. We need government regulation to ensure that our needs are not lost in the deregulation suffle.

Thank you for the opportunity to testify here today.

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Proposal No. 1

Beginning January 1, 1985, banks (commercial banks, savings banks and savings and loan associations) should be authorized by statute to act directly as insurance agents and brokers. Banks should be authorized to sell insurance both on the premises of their existing branches or at other locations. In addition, their authority to lease space in branch locations to independent insurance agents in accordance with current Banking Department interpretations should be confirmed by statute.

Proposal No. 2

Beginning January 1, 1985, all types of banks should also be authorized to own, manage and control subsidiary corporations which act as insurance agents and brokers. Thrift institutions which are currently authorized to engage in such activities through service corporation subsidiaries should be permitted to continue to do so in 1984. Both commercial banks and thrifts should be limited as to the amount which they can invest in such insurance agency subsidiaries, in a manner similar to the limitation which now applies only to thrift institutions (which is currently 3% of assets for equity investments).

Proposal No. 3

Banks which act as insurance agents or brokers should be licensed and subject to regulation by the Insurance Department in the same manner as are other agents, and the sale of insurance by banks should be conducted only by individuals who are so licensed and regulated.

Proposal No. 4

During a transition period of three years from the initial effective date (January 1, 1985) of legislation authorizing banks to act as insurance agents and brokers, each office or other location at which a bank offers insurance for sale to the public should be under the supervision of an agent, located on the premises, who has been licensed by the Insurance Department for at least three years and has three years of actual experience as an agent. This requirement would not apply to savings banks which limit their insurance activities solely to the sale of savings bank life insurance.

Proposal No. 5

Effective January 1, 1986, Section 7-b of the Insurance Law -- which prohibits an agent controlled by a bank from writing property and casualty insurance on property which is the subject of, or collateral for, a loan -- should be repealed. Concurrently, however, the Insurance Department should be given the power to suspend or revoke the authority of a bank or other lender to act as an insurance agent or broker upon a finding that it has engaged in anti-competitive practices (including violations of Section 7-a of the Insurance Law) in the sale of insurance in connection with the making of loans.

Until the effective date of the repeal of Section 7-b, its provisions should be made uniform so as to apply to certain lenders (including federally-chartered stock savings banks, non-New York thrift institutions and securities firms) which may offer insurance in connection with property loan transactions.

Proposal No. 6

A variety of measures should be adopted to discourage the possibility of coercion of insurance consumers by banks and other lenders, including: requiring lenders who sell insurance to offer policies which provide a 30-day cancellation privilege; prohibiting lenders from soliciting insurance from prospective borrowers prior to approval of their credit application; strengthening Section 7-a of the Insurance Law; and requiring improved disclosure to consumers.

Proposal No. 7

In addition to the power granted to the Insurance Department to suspend or revoke the agency authority of a bank for violations of the anti-tie-in provisions, the Superintendent of Insurance should have the authority to obtain injunctive relief pursuant to Section 35 of the Insurance Law and authority to request the Attorney General to maintain a civil action in the name of the people of the state or intervene in an action brought by policyholders for the recovery of treble damages or for other appropriate equitable relief.

Proposal No. 8

State-chartered banks should be able to own and acquire life insurance companies -- but only through a parent holding company -- effective January 1, 1986, or, if earlier, the date on which holding companies controlling national banks are permitted to do so under the federal Bank Holding Company Act.

Banks should also be authorized to own and acquire property and casualty insurance companies through a parent holding company, but only after a further study of the matter and then on or after January 1, 1988 or, if earlier, the date on which national bank holding companies are authorized to do so.

On the same date as State-chartered banks are authorized to own and acquire insurance companies (January 1, 1986 for life insurance companies and January 1, 1988 for property and casualty insurance companies) such insurance companies should be authorized to own and acquire -- through a parent holding company -- control of a State-chartered commercial bank, a national bank having its head office in New York or a stock-form thrift institution havings its head office in New York.

Prior to January 1, 1987, the Superintendents of Banks and Insurance should conduct a joint study of the advisability of authorizing banks to own or be affiliated with underwriters of property and casualty insurance under the circumstances then existing.

Proposal No. 9

If federal law does not permit such holding company affiliations on the relevant effective dates (January 1, 1986 for life insurance companies and January 1, 1988 for property and casualty companies), then State-chartered banks should be able to own the stock of a New York domestic insurance company directly, in which case the bank's investment in the stock of all insurance companies should be limited to 2% of the assets of the bank (unless a greater percentage shall be approved in a specific case by the Superintendent of Banks).

Likewise, in such circumstances, a domestic insurance company should be able to own and control the stock of a bank to the extent permitted by the Bank Holding Company Act.

Proposal No. 10

Even if federal law on the delayed effective dates permits affiliations of banks and insurance companies only in a holding company structure, as a matter of State law New York-chartered mutual (but not stock) insurance companies should be permitted to own and/or control the stock of a subsidiary engaged in the banking business, subject to the limitations on investments in subsidiaries currently contained in Section 46-a of the Insurance Law (2% of assets for any single subsidiary and 10% for all subsidiaries).

Similarly, on such dates mutual savings banks and mutual savings and loan associations should be authorized to own insurance subsidiaries, provided the parent thrift's aggregate investment did not exceed 2% of its total assets.

Proposal No. 11

The current New York insurance holding company law should apply to any bank/insurance company conglomerate, and the statute should be strengthened to cover transactions between an insurance company and a subsidiary bank.

Proposal No. 12

Prior to the effective date of Proposal No. 8, the Attorney General should appoint a special task force to review the State's antitrust laws to determine if they are sufficient to prevent excessive concentration of resources in the financial sector as a reuslt of bank-insurer acquisitions.

Proposal No. 13

Domestic property and casualty insurers owned by or affiliated with banks should be subject to the increased accountability provisions of Section 48-b of the Insurance Law -- at least one-third outside directors and at least one committee of the board of directors composed entirely of outside directors.

Proposal No. 14

Domestic and authorized foreign insurers should be required to report specifically to the Insurance Department any "significant portfolio transaction" (investments, exchange of securities, prepayments of borrowings, etc.) with a third party (borrower or portfolio company) where the insurer knows, or should know, that the third party has a significant commercial banking relationship with a bank which is affiliated with the insurer.

Proposal No. 15

The Legislature should give consideration to increasing the existing limitations on savings bank life insurance and extending the program to State-chartered savings and loan associations.

In addition, eligibility for SBLI should be extended to spouses of New York residents.

Proposal No. 16

New York's policy should be to permit the chartering and formation of "nonbank" banks -- banks that either do not make commercial loans or do not accept demand deposits -- by any individual or type of organization meeting existing standards for organizing and controlling a bank.

Proposal No. 17

The provisions of the Banking Law restricting affiliations between State-chartered commercial banks and securities companies (the "mini-Glass-Steagall Act") should be repealed, to be effective in the event of repeal of the federal Glass-Steagall Act.

Proposal No. 18

The limits on the acceptance of deposits by State-chartered thrifts should be significantly liberalized by:

(a) eliminating prohibitions on the assessment of service charges on demand deposit accounts;

(b) allowing thrifts to accept deposits from businesses without requiring that there be a loan relationship;

(c) giving thrifts the right to issue negotiable certificates of deposit; and

(d) authorizing the acceptance of municipal deposits on the same basis as commercial banks.

Proposal No. 19

The existing detailed criteria governing thrift institution investments in securities should be eliminated and replaced by a "prudent person" rule, subject to a prohibition on acquiring controlling equity positions and a requirement of greater accountability to outside directors.

Proposal No. 20

The current statutory limitation on conventional mortgage lending on improved real property outside of New York (and adjoining states within 75 miles of a thrift's head office) should be eliminated.

Proposal No. 21

"Home office protection" for commercial banks in communities with 50,000 or less population should be repealed in successive stages between January 1, 1985 and January 1, 1988. Beginning on January 1, 1985, home office protection as it applies to automated teller machines (ATMs) should be eliminated. Beginning on January 1, 1987, home office protection should be eliminated as it applies to manned branches in communities of between 15,000 and 50,000 population. On January 1, 1988 home office protection should be eliminated in communities of less than 15,000.

Proposal No. 22

The New York State and New York City alternative minimum taxes on interest and dividends paid by savings banks and savings and loan associations should be repealed.

Proposal No. 23

State-chartered banks and thrift institutions should be given broader authority to make "equity investments" in real estate and to act as property manager in connection with such investments.

Proposal No. 24

Mutual life insurance companies should be permitted to reorganize to stock-owned form (demutualize).

Proposal No. 25

Section 214 of the Insurance Law should be repealed and replaced with two new statutory requirements: that the board of directors of domestic life insurance companies specifically approve the compensation of all "principal" officers, employees and consultants, and that fringe benefits (i.e., bonuses, deferred compensation, employment contracts and pension plans) not be unreasonable.

Proposal No. 26

The Insurance Department and the Division of the Budget should conduct a review of the adequacy of the Department's budget for future years. In addition, the Insurance Department should develop a proposal for change in its examination process and the costs of examinations should be assessed more equitably.

Proposal No. 27

The appropriate agencies within the State (the Budget Division, the Civil Service Commission and the Governor's Office of Employee Relations), in conjunction with the Banking and Insurance Departments, should review the feasibility of providing enhanced compensation to the professional staffs of the two Departments, and make recommendations for appropriate action to the Governor and the Legislature.

Proposal No. 28

The Governor should consider establishing a sub-cabinet level inter-agency working group on financial services.

Proposal No. 29

With certain modifications as described herein, the Life Insurance Guaranty Corporation should be modernized as proposed in a pending bill in the Legislature (A. 7143, S. 5776). The legislation should include a modified "tax offset" provision.

Proposal No. 30

Legislation should be enacted to extend guaranty fund protection to all health insurance policyholders in New York. The Insurance Department should examine whether existing guaranty funds should be broadened or a new health insurance guaranty fund should be established, and should make appropriate recommendations to the Governor within the current year.

Proposal No. 31

By July 1, 1985, the Superintendent of Insurance, in consultation with the State Consumer Protection Board, should examine the current system of life insurance cost disclosure to determine if it is providing sufficient information to the consumer and should make appropriate recommendations to the Legislature.

Proposal No. 32

The State should require that some type of "lifeline" bank account be available through state-chartered depository institutions that would offer consumers basic banking services at minimal cost.

Proposal No. 33

The Banking Board should promulgate for a three-year test period a Supervisory Procedure that would require a bank to report to the Superintendent a planned branch closing in specified geographical areas three months before the actual event. In addition, if the Superintendent determines that the closing could significantly reduce the availability of bank services in the community, he should institute, upon receipt of such a notice, a series of structured discussions among the bank, community leaders and the Banking Department to determine the feasibility of replacing that branch with other community-oriented banking services.

Proposal No. 34

The State should develop a comprehensive strategy that could replace branches in low- and moderate-income communities threatened with closure with new community-oriented institutions that will provide basic banking services.

Proposal No. 35

The Banking Department's Supervisory Procedure G-107 (Reports of Mortgage and Home Improvement Data by Banking Organizations) should be amended to require reporting by banks on their lending to small businesses.

Proposal No. 36

Mortgage bankers who originate more than $1 million in mortgages annually should be required to report annually on their home mortgage and home improvement lending in a manner and form comparable to the reports made by State banks and savings institutions pursuant to Supervisory Procedure G-107.

Proposal No. 37

The State should endeavor to increase the availability of credit for New York small businesses by expanding the secondary market for small business loans originated by New York State-chartered banks.

Proposal No. 38

The State should seek to increase the availability of capital for community development projects and small businesses in the State through a deposit/lending program involving the State's Common Retirement Fund and its State-chartered banks.

MORTGAGE LENDING IN NEW YORK CITY - 1981

A PRELIMINARY REPORT

ACKNOWLEDGMENTS

We wish to thank New York State Banking Department for making the mortgage data in this report available for our use. The data was compiled by Survey Data Security Corporation of New York.

The data and tables were prepared by Eileen Murray of the City of New York Commission on Human Rights, Neighborhood Stabilization Program and Fred Gonzalez of New York University, Metropolitan Studies Program and produced by Haydee Garcia of the City Commission on Human Rights. For additional copies or information contact Eileen Murray, 233-4410 or Marion Swan, 964-7200.

December 1982

Mortgage Lending: A Clearer Picture

By Marlon Swan

To neighborhood residents organizing for community reinvestment by banks in loan-starved areas, the banker's refrain is all to familiar: "My bank wants to lend mortgages in your neighborhood, but we haven't received any applications." Now, through newly gathered information available at the state Banking Department, neighborhood groups can counter that lament with hard proof that there is an active mortgage market in their communities. Using the mortgage data, they will also be able to show statistically which financial institutions are meeting that demand, and which ones – namely, the banks – are so inactive that many neighborhood residents have given up on even applying.

Survey Data Corporation, a private firm under contract with the banking department, recently started compiling mortgage activity information about four boroughs in New York City (excluding Staten Island) as well as Nassau and Westchester counties in greater detail than ever before; this at the urging of reinvestment activists who sought a more comprehensive picture of real estate activity in order to identify appropriate sources [illegible] mortgage financing and better measure the effects [illegible] neighborhood-based reinvestment efforts.

The Survey Data information breaks down all recorded mortgages in the areas covered according to the following categories: one-to-six-unit homes; multi-unit buildings (properties with more than six apartments, including co-ops); industrial buildings; retail commercial properties; office commercial buildings; condominia, and other types (a catch-all including anything not covered by the preceeding categories).

The mortgage data about these various types of property is available in numerous formats, broken down according to county, zip code, census tract, building type, lender type and lender.

A preliminary study of the 1981 Survey Data report, released in September, shows:

- 81.4 percent of mortgage financing for multi unit buildings was provided by other financial institutions (mortgage funding companies, credit unions, etc.) and purchase money mortgages (PMMs), private arrangements between sellers and buyers.
- commercial banks and thrift institutions (savings banks and savings and loan associations) outranked other financial institutions and PMMs in *only* one category – condos.
- banks and thrift institutions were outranked in each of the four boroughs when the activities of other financial institutions and PMMs were combined.
- banks and thrift institutions accounted for only 33.5 percent of the mortgage activity in all of New York City compared to 53.3 percent in Nassau County and 48.6 percent in Westchester County.
- in non-housing related mortgages, banks and thrift institutions provided only 15.3 percent of the industrial mortgages, 16.6 percent for retail commercial and outranked PMMs and other financial institutions only in the area of office commercial with 40.7 percent of the market.
- in total dollars invested by banks and thrifts in one-to-six-unit buildings, the Bronx received only 29.1 percent of its loans, Brooklyn got 57.1 percent and Queens received 50 percent – in contrast to Manhattan, where banks and thrifts lent 81.4 percent of such mortgage dollars.

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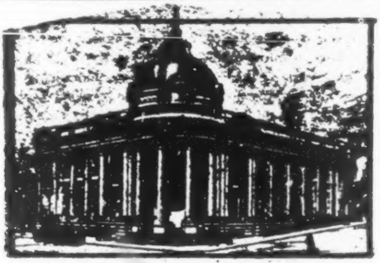

These conclusions raise several important questions for reinvestment strategists:

Why are people turning away from the traditional mortgage lenders?

Why do bankers continuously maintain that their is no mortgage market, when one obviously exists?

In a city filled with multi-unit buildings, why do banks and thrifts continue to ignore this crucial area?

Many mortgage lending companies deal exclusively with Federal Housing Administration, government-backed mortgages. Are banks and thrift institutions closing their doors on this market and, if so, why?

What effect will these mortgage lending practices have on the future of homeownership in our neighborhoods?

Why are banks and thrift institutions not meeting the credit needs of our commercial and industrial communities?

It seems clear that the newly expanded picture of mortgage activity could begin a whole new era of reinvestment negotiations between community groups and banks and thrifts. With that additional leverage, neighborhood residents may be able to get closer to a fair share of investment for housing and commercial revitalization.

The availability of this new data is the result of a cooperative effort between Stephen Casella and David Kahn of the Banking Department's Community Reinvestment Office, Dan Kilfoyle of the Survey Data Corporation, Eileen Murray of the Neighborhood Stabilization Program/City Commission on Human Rights, Marc Jahr, Executive Director of the East Flatbush Neighborhood Housing Service and Marion Swan of the Community Training and Resource Center.

For further information on the mortgage data, contact Marion Swan, at the Community Training & Resource Center, (212) 964-7200, Eileen Murray at the NYC Commission on Human Rights, (212) 233-4410.

* * * * *

HOW TO READ THE TABLES

TABLE I: Table I indicates the total number of mortgages made for each building type, for each borough, by each type of lender. For example, in the Bronx, of all the mortgages loans made on 1-6 unit buildings, banks and thrifts made 26.7 percent, other financial institutions (such as finance companies, mortgage funding companies, etc.) made 48.5 percent and individuals through purchase money mortgages (PMM's) made 24.5 percent.

TABLE II: Table II indicates the same type of information for dollar amounts (in the thousands). For 1-6 unit buildings in the Bronx, there was $62,363,000 made in mortgage loans. Banks and thrifts made 29.1 percent, other financial institutions made 55.1 percent and individuals (PMM's) made 15.7 percent of the total dollar investments.

TABLE III: This Table indicates every bank that is located in each borough. For Bronx county, Amalgamated Bank has two branches and deposits of $27,450,000. This represents approximately 0.4 percent of all the deposits in the Bronx. This amount represents approximately 0.03 percent of Amalgamated Bank's deposits in 1981.

NOTES AND DEFINITIONS

MORTGAGE DATA: The mortgage data in the following tables was supplied by Survey Data Security Corporation as part of their contract with New York State Banking Department. Survey Data basis their data directly from the information recorded in the county clerks office of public records of the county register. Acording to Survey Data, their error rate is between two and three percent.

Counties: In New York City, the data is available for every borough except Staten Island. We will attempt to include Staten Island in later studies.

Lenders; Lenders are classified into the following three categories:

A. Banks and Thrifts: This includes federal and state chartered commercial banks, and thrift institutions which includes both savings banks and savings and loan associations.
B. Other Financial Institutions: This includes all other institutional lenders such as finance companies, mortgage funding companies, life insurance companies, credit unions and government.
C. PMM or Purchase Money Mortgages: This category includes all seller financed mortgages.

Buidling Classifications: In New York City, every mortgage is categorized according to the building classifications used by City Planning and the Buildings Department. Home improvement loans using a second mortgage are included as mortgages on 1-6 unit buildings. Co-op loans are included with multiple dwellings. Nassau and Westchester counties do not use the same classifications. Therefore, we do not have building type classifications for them. We do have the total mortgages made in those counties and they are included under the total column.

Full Report: The complete Mortgage Activity Report from Survey Data Security Corporation consists of sixteen reports. The most detailed report lists every single mortgage transaction by the name of the lender for every census tract. This will eventually permit each neighborhood to know who made every loan in their area for which type of structure.

DEPOSIT DATA: **

FDIC Insured Banks: Deposits for FDIC insured banks are as of June 30, 1981 and includes all deposits--demand, savings and time deposits for individuals, partnerships, corporations and public funds. We have not included foreign banks which have branches in New York City. New York County (Manhattan) has the largest number of such branches. FDIC lists every branch unit as a branch i.e., full service branches, electronic fund transfer units and drive in units. (Source: Bank and Branches Data Book, June 30, 1981. Vol 2. FDIC. Division of Accounting and Corporate Services, Bank Statistics Branch. Washington, D.C.)

FSLIC Insured Banks: Deposits are as of September 30, 1981 and include savings only. Branches all appear to be full service branches. (Source: Federal Home Loan Bank of New York, Second District, Survey by Office, September 30, 1981.)

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TABLE I.

TOTAL NUMBER OF MORTGAGES BY TYPE OF LENDER-1981

	BANKS & THRIFTS		OTHER FINANCIAL INSTITUTIONS		PMM		TOTAL	
	#	%	#	%	#	%	#	%
A. 1-6 FAMILY BUILDING								
Bronx	477	26.7	866	48.5	437	24.5	1,784	99.7
Brooklyn	2915	44.8	1624	24.9	1,965	30.2	6,504	99.9
Manhattan	95	40.8	44	18.9	94	40.3	233	100.0
Queens	3661	40.7	3176	35.3	2,159	24.0	8,996	100.0
Total:	7152	40.8	5710	32.6	4,655	26.6	17,517	100.0
B. MULTIPLE DWELLINGS								
Bronx	97	15.4	301	48.0	230	36.6	628	100.0
Brooklyn	542	21.4	682	27.0	1,306	51.6	2,530	100.0
Manhattan	346	15.4	1044	46.6	850	37.9	2,240	99.9
Queens	172	20.5	255	30.3	414	49.2	841	100.0
Total:	1157	18.5	2282	36.6	2,800	44.9	6,239	100.0
C. CONDO								
Bronx	7	2.2	290	91.8	19	6.0	316	100.0
Brooklyn	1	33.3	1	0	2	66.6	3	99.9
Manhattan	130	74.7	30	17.2	14	8.0	174	99.9
Queens	261	90.3	17	5.9	11	3.8	289	100
Total:	399	51.0	337	43.1	46	5.9	782	100
D. INDUSTRIAL								
Bronx	9	11.7	46	59.7	22	28.6	77	100.0
Brooklyn	28	9.3	126	41.9	147	48.8	301	100.0
Manhattan	15	14.3	60	57.1	30	28.6	105	100.0
Queens	51	26.4	67	34.7	75	38.8	193	99.9
Total:	103	15.2	299	44.2	274	40.5	676	99.9
E. RETAIL COMMERCIAL								
Bronx	19	12.4	47	30.7	87	56.9	153	100.0
Brooklyn	47	12.2	120	31.0	220	56.8	387	100.0
Manhattan	51	25.0	86	42.2	67	32.8	204	100.0
Queens	67	18.7	117	32.6	175	48.7	359	100.0
Total:	184	16.7	370	33.5	549	49.8	1,103	100.0
F. OFFICE COMMERCIAL								
Bronx	2	22.2	4	44.4	3	33.3	9	99.9
Brooklyn	14	46.7	5	16.7	11	36.7	30	100.1
Manhattan	79	42.2	84	44.9	24	12.8	187	99.9
Queens	3	20.0	3	20.0	9	60.0	15	100.0
Total:	98	40.7	96	39.8	47	19.5	241	100.0
G. OTHER								
Bronx	67	20.7	149	46.2	107	33.1	323	100.0
Brooklyn	444	24.5	453	25.0	914	50.5	1,811	100.0
Manhattan	212	27.1	367	46.9	204	26.1	783	100.1
Queens	437	38.5	236	20.7	463	40.8	1,136	100.0
Total:	1,160	28.6	1,205	29.7	1,688	41.6	4,053	99.9
H. TOTAL								
Bronx	682	20.7	1,703	51.8	905	27.5	3,290	100.0
Brooklyn	3,991	34.5	3,010	26.0	4,565	39.5	11,566	100.0
Manhattan	928	23.6	1,715	43.6	1,283	32.7	3,926	99.9
Queens	4,652	39.3	3,871	32.7	3,306	27.9	11,829	99.9
Total:	10,253	33.5	10,299	33.6	10,059	32.9	30,611	100.0
Nassau	7,583	53.0	3,289	23.0	3,425	24.0	14,297	100.0
Westchester	3,683	48.6	1,624	21.4	2,272	30.0	7,579	100.0

TABLE II.

TOTAL DOLLAR AMOUNT OF MORTGAGES BY THE TYPE OF LENDER-1981

(Figures in 000's)

	BANKS & THRIFTS		OTHER FINANCIAL INSTITUTIONS		PMM		TOTAL	
A. 1-6 FAMILY BUILDINGS	$	%	$	%	$	%	$	%
Bronx	18,174	29.1	34,368	55.1	9,821	15.7	62,363	99.9
Brooklyn	126,271	57.1	49,588	22.4	45,276	20.5	221,135	100.0
Manhattan	120,610	81.4	14,854	10.0	12,725	8.6	148,189	100.0
Queens	159,490	50.0	104,395	32.7	55,283	17.3	319,168	100.0
Total:	424,543	56.5	203,206	27.1	123,106	16.4	750,855	100.0
B. MULTIPLE DWELLING								
Bronx	29,686	26.4	66,313	59.0	16,409	14.6	112,409	100.0
Brooklyn	74,627	36.5	75,459	36.9	54,623	26.7	204,709	100.1
Manhattan	285,578	35.0	395,461	48.4	135,417	16.6	816,456	100.0
Queens	24,117	19.1	68,321	54.0	34,123	27.0	126,561	100.1
Total:	414,008	32.9	605,550	48.1	240,573	19.1	1,260,136	100.1
C. CONDO								
Bronx	502	12.6	3,240	81.3	241	6.1	3,983	100.0
Brooklyn	90	76.9	- -	-	27	23.1	117	100.0
Manhattan	23,319	85.7	1,479	5.7	2,239	8.6	26,037	100.0
Queens	11,383	95.0	390	3.3	214	1.8	11,987	100.1
Total:	34,292	81.4	5,109	12.1	2,722	6.5	42,125	100.0
D. INDUSTRIAL								
Bronx	2,105	19.2	5,698	51.9	3,181	29.0	10,984	100.1
Brooklyn	11,633	26.5	23,546	53.6	8,771	20.0	43,950	100.1
Manhattan	8,273	19.5	27,448	64.8	6,694	15.8	42,415	100.1
Queens	10,844	40.9	8,793	33.1	6,897	26.0	26,534	100.0
Total:	32,854	26.5	65,485	52.9	25,542	20.6	123,884	100.0
E. RETAIL COMMERCIAL								
Bronx	10,592	60.0	3,057	17.3	4,006	22.7	17,656	100.0
Brooklyn	8,284	22.1	9,799	26.2	19,370	51.7	37,453	100.0
Manhattan	126,195	62.3	60,264	29.8	16,052	7.9	202,511	100.0
Queens	4,303	17.4	8,885	36.0	11,484	46.5	24,672	99.9
Total:	149,371	52.9	82,006	29.1	50,913	18.1	282,292	100.1
F. OFFICE COMMERCIAL								
Bronx	375	36.6	403	39.3	246	24.0	1,025	99.9
Brooklyn	9,345	53.2	7,699	43.9	511	2.9	17,555	100.0
Manhattan	396,687	51.0	369,77[illegible]	47.5	11,426	1.5	777,890	100.0
Queens	1,165	46.4	864	34.4	480	19.1	2,509	99.9
Total:	407,572	51.0	378,743	47.4	12,662	01.6	798,979	100.0
G. OTHER								
Bronx	26,131	47.1	23,049	41.6	6,244	11.3	55,424	100.0
Brooklyn	39,336	14.1	212,810	76.2	27,030	9.7	279,176	100.0
Manhattan	509,554	54.4	337,812	36.0	90,059	9.6	937,425	100.0
Queens	51,578	17.8	215,201	74.4	22,332	7.7	289,111	99.9
Total:	626,597	40.1	788,870	50.5	145,666	9.3	1,561,136	99.9
H. TOTAL								
Bronx	87,563	33.2	136,129	51.6	40,149	15.2	263,842	100.0
Brooklyn	269,588	33.5	378,902	47.1	155,608	19.4	804,098	100.0
Manhattan	1,469,218	49.8	1,207,095	40.9	274,613	9.3	2,950,926	100.0
Queens	262,882	32.8	406,848	50.8	130,815	16.3	800,545	99.9
Total:	2,089,248	43.4	2,128,977	44.2	601,187	12.4	4,819,412	100.0
Nassau	567,210	53.9	308,696	29.3	177,146	16.8	1,053,052	100.0
atchester	324,818	55.1	143,489	24.3	121,185	20.6	589,494	100.0

TABLE III.

A COMPARISON OF TOTAL BANK DEPOSITS TO TOTAL MORTGAGE LOANS BY BOROUGH-1981

BRONX COUNTY	# Of Branches	DEPOSITS		MORTGAGE LOAN ACTIVITY		Ratio of Total Loans to Total Deposits
		Total $ Amt. (in 000's)	As a % of Boro's Total Deposit	Total # of Loans	Total $ Amt. (in 000's)	
FDIC INSURED						
Amalgamated Bank of NY	2	27,450	0.4	1	8	0.03
Banco Central of NY	1	5,055	0.0	-	-	-
Banco de Ponce	2	22,921	0.4	3	20	0.09
Banco Popular de Puerto Rico	1	16,811	0.3	1	300	1.78
Bank Leumi Trust of NY	1	23,479	0.4	1	1,200	5.11
Bank of Commerce	3	16,149	0.3	35	227	1.40
Bankers Trust	2	20,790	0.3	-	-	-
Citibank	23	618,843	10.0	153	26,420	4.26
Chase Manhattan	23	452,291	7.3	48	12,006	2.65
Chemical	20	338,684	5.5	59	18,771	5.54
Dime Savings Bank of NY	1	45,186	0.7	11	316	0.70
Dollar Savings Bank of NY	8	1,747,026	28.2	23	963	0.06
Eastern Savings Bank	6	510,655	8.2	8	339	0.07
European American Bank & Trust	2	46,750	0.8	7	543	1.16
Independence Savings Bank	1	74,073	1.2	2	90	0.12
Manufacturers Hanover Trust	23	467,702	7.5	35	1,228	0.26
Marine Midland Bank of N.A.	2	49,358	0.8	12	409	0.83
National Bank of N.A.	3	51,198	0.8	-	-	-
Northside Savings Bank	5	429,510	6.9	12	561	0.13
Republic National Bank of NY	1	9,820	0.2	-	-	-
Union Dime Savings	1	124,834	2.0	-	-	-
United Mutual Savings Bank	1	106,844	1.7	-	-	-
FSLIC INSURED						
First Federal S & L of Rochester	1	76,645	1.2	-	-	-
First Federal S & L of NY	4	119,498	1.9	1	48	0.04
Fourth Federal S & L of NY	1	44,298	0.7	9	569	1.28
Knickerbocker Federal S & L	4	220,300	3.5	38	1,710	0.78
Ninth Federal S & L	2	42,833	0.7	43	2,039	4.76
Ponce De Leon S & L	1	19,592	0.3	15	463	2.36
Tremont S & L	2	80,468	1.3	-	-	-
Yorkville Federal S & L	5	92,885	1.5	37	1,726	1.86
TOTAL DEPOSITS FSLIC & FDIC		6,200,630				

TABLE III (con't)

KINGS COUNTY	# Of Branches	DEPOSITS		MORTGAGE LOAN ACTIVITY		Ratio of Total Loans to Total Deposits
		Total $ Amt. (in 000's)	As a % of Boro's Total Deposit	Total # of Loans	Total $ Amt. (in 000's)	
FDIC INSURED						
American Savings Bank	4	483,918	3.0	8	1,047	00.22
Atlantic Bank	1	22,673	0.1	41	2,190	09.66
Banco de Ponce	3	41,135	0.3	20	134	00.32
Banco Central of NY	1	9,992	0.0	-	-	-
Banco Popular de Puerto Rico	1	13,731	0.1	1	40	00.29
Bank of Commerce	4	41,950	0.3	51	423	01.01
Bank Leumi Trust	5	88,033	0.6	8	473	00.54
Banker Trust	5	108,769	0.7	21	1,078	01.00
Bowery Savings	5	420,829	2.6	11	492	00.12
Brooklyn Savings Bank	5	923,081	5.8	15	457	00.05
Central National Bank	2	32,513	0.2	-	-	-
Chase Manhattan Bank	20	353,937	2.2	57	3,8[illegible]5	01.08
Chemical Bank	18	307,626	1.9	140	16,789	05.46
Citibank	40	850,193	5.3	846	67,561	07.95
Community National Bank	1	10,163	1.0	-	-	-
Dime Savings Bank	8	2,413,763	15.2	189	10,747	00.45
East New York Savings Bank	4	298,385	1.9	29	12,343	04.14
Emigrant Savings Bank	3	263,754	1.7	9	557	00.21
European American Bank	3	67,738	0.4	5	2,232	03.30
Freedom National Bank	1	711	0.0	6	650	09.28
Greater New York Savings Bank	9	1,326,130	8.3	290	14,595	01.10
Greenpoint Savings Bank	7	806,522	5.1	733	33,015	04.29
Hamburg Savings Bank	3	312,559	2.0	21	531	00.17
Lincoln Savings Bank	6	1,128,747	7.1	48	3,034	00.27
Manufacturer Hanover Trust	48	1,105,114	6.9	114	11,350	01.03
Metropolitan Savings Bank	11	1,269,313	8.0	110	4,520	00.36
National Bank of N.A.	8	80,340	0.5	18	4,022	05.01
Republic National Bank of NY	11	599,132	3.8	2	20	00.00
Richmond County Savings	2	21,286	0.1	9	292	01.37
Roosevelt Savings Bank	2	320,897	2.0	52	1,451	00.45
United Mutual Savings	2	75,849	0.5	3	633	00.83
Williamsburg Savings Bank	4	873,492	5.5	92	3,433	00.39
FSLIC INSURED						
American S & L	1	2,500	0.0	1	5	00.02
Atlantic Liberty S & L	2	48,255	0.3	8	640	01.33
Atlas S & L	1	30,055	0.2	22	726	02.42

TABLE III (con't)

KINGS COUNTY	# Of Branches	DEPOSITS		MORTGAGE LOAN ACTIVITY		Ratio of Total Loans to Total Deposits
		Total $ Amt. (in 000's)	As a % of Boro's Total Deposit	Total # of Loans	Total $ Amt. (in 000's)	
Bankers Fed. S & L	1	66,785	0.4	1	14	00.02
Bayridge S & L	5	172,248	1.0	33	2,352	01.37
Brooklyn Fed. S & L	2	70,263	0.4	25	1,061	01.15
Carver Fed S & L	2	25,733	0.2	2	40	00.16
County Fed. S & L	1	40,552	0.3	2	35	00.10
Cross County Fed. S & L	1	13,192	0.1	-	-	-
Edison Savings & Loan	1	12,636	0.1	5	187	01.48
Financial Fed. S & L	1	14,916	0.1	-	-	-
First Fed. S & L of Rochester	1	24,736	0.2	-	-	-
Flatbush Fed. S & L of Brooklyn	3	123,315	0.8	-	-	-
Hamilton Fed. S & L	6	247,345	1.6	153	7,417	03.00
Knickerbocker Fed. S & L	1	9,614	0.1	7	295	03.07
Nassau S & L	1	26,481	0.2	1	130	00.50
Ninth Fed. S & L	1	20,427	0.1	295	13,514	66.16
Pioneer S & L	4	78,789	0.5	12	543	00.67
Serial Fed. S & L	1	6,722	0.0	6	280	04.17
West Side Fed. S & L	2	194,601	1.2	53	4,219	02.17
TOTAL DEPOSITS FSLIC & FDIC		15,907,840				

TABLE III (con't)

MANHATTAN	# Of Branches	DEPOSITS		MORTGAGE LOAN ACTIVITY		Ratio of Total Loans to Total Deposits
		Total $ Amt. (in 000's)	As a % of Boro's Total Deposit	Total # of Loans	Total $ Amt. (in 000's)	
FDIC INSURED						
Amalgamated Bank of NY	2	500,403	0.3	17	2,326	00.46
American Savings	23	1,279,061	0.9	16	3,430	00.27
Banco Central of NY	3	47,805	0.0	-	-	-
Banco de Ponce	4	79,981	0.1	3	210	00.26
Banco Popular de Puerto Rico	3	51,591	0.0	1	50	00.10
Bank Leumi Trust	13	861,459	0.6	13	10,728	01.25
Bank of Commerce	7	219,512	0.1	1	9	00.00
Bankers Trust Co.	15	11,897,742	8.0	15	20,741	00.17
Barclays Bank of NY	5	138,475	0.1	2	2,225	01.61
Bowery Savings Bank	12	3,469,766	2.3	2	190	00.01
Brooklyn Savings	1	75,097	0.1	3	13	00.02
Citibank N.A.	83	17,344,519	11.7	206	222,713	01.28
Central Savings	5	626,986	0.4	6	7,984	01.26
Chase Manhattan Bank	65	23,884,942	16.0	164	452,014	01.89
Chemical Bank	84	15,044,219	10.1	95	224,714	01.49
Dime Savings	3	661,700	0.4	8	3,708	00.56
Dollar Savings Bank of NY	1	161,071	0.1	8	3,753	02.33
Dry Dock Savings Bank	11	1,453,802	1.0	3	390	00.03
East New York Savings	6	487,667	0.3	7	10,218	02.10
East River Savings	8	1,013,419	0.7	6	1,639	00.16
Emigrant Savings	12	1,802,446	1.2	14	1,366	00.08
European American Bank & Trust	13	2,413,570	1.6	44	111,572	04.62
Greater New York Savings	4	278,177	0.2	2	163	00.06
Greenwich Savings	10	1,508,750	1.0	4	626	00.04
Harlem Savings	6	661,527	0.4	24	6,671	01.01
Independence Savings	1	30,854	0.0	5	1,226	03.97
Irving Trust	16	7,426,753	5.0	2	7,000	00.09
Jamaica Savings	2	63,669	0.0	-	-	-
Lincoln Savings Bank	5	289,530	0.2	4	4,320	01.49
Lincoln First Bank N.A.	2	13,719	0.0	-	-	-
Long Island Trust Co.	1	1,087	0.0	-	-	-
Manhattan Savings	8	1,282,944	0.9	13	14,825	01.16
Manufacturer and Traders Trust	2	37,756	0.0	0	0	-
Manufacturer Hanover Trust Co.	66	19,297,280	13.0	72	182,163	00.94
Marine Midland	13	2,923,080	2.0	6	1,143	00.04
Merchants Bank of New York	5	183,477	0.1	-	-	-
Metropolitan Savings	4	173,770	0.1	1	37	00.02

TABLE III (con't)

MANHATTAN	# Of Branches	DEPOSITS		MORTGAGE LOAN ACTIVITY		Ratio of Total Loans to Total Deposits
		Total $ Amt. (in 000's)	As a % of Boro's Total Deposit	Total # of Loans	Total $ Amt. (in 000's)	
Morgan Guaranty Trust	5	17,194,956	11.6	5	1,783	00.01
National Bank of N.A.	15	1,043,971	0.7	9	15,274	01.46
New York for Savings	17	2,153,314	1.4	-	-	-
Republic National Bank	13	1,639,452	1.1	9	3,381	00.21
Seamens Bank for Savings	5	1,271,405	0.9	1	750	00.05
The Bank of New York	9	2,891,272	1.9	7	2,674	00.09
Union Chelsea National Bank	4	66,174	0.0	-	-	-
Union Dime Savings Bank	4	913,224	0.6	5	421	00.05
United Mutual Savings Bank	5	361,179	0.2	-	-	-
United States Trust Co.	3	1,141,174	0.7	1	525	00.05
Williamsburg Savings	2	191,685	0.1	2	115	00.05
FSLIC INSURED						
American S & L	1	28,529	0.0	-	-	-
Bankers Fed. S & L	3	101,053	0.0	-	-	-
Carver Fed. S & L	2	49,242	0.0	1	45	00.09
Central Fed. S & L of Nassau County	3	94,470	0.0	-	-	-
Columbia S & L	1	30,320	0.0	5	1,980	06.53
County Fed. S & L	2	34,588	0.0	-	-	-
Dollar Fed. S & L	2	21,192	0.0	-	-	-
Edison Fed. S & L	1	63,249	0.0	-	-	-
First Fed. S & L of NY	7	109,091	0.1	-	-	-
First Fed. S & L of Rochester	2	221,799	0.1	-	-	-
Fourth Fed. S & L of NY	2	65,057	0.0	4	415	00.64
Ninth Fed. S & L	2	51,058	0.0	-	-	-
Serial Fed. S & L	2	38,673	0.0	-	-	-
Union Fed. S & L	1	30,806	0.0	1	600	01.95
Washington Fed. S & L	3	154,711	0.1	-	-	-
West Side Fed. S & L	4	581,180	0.4	-	-	-
Yorkville Fed. S & L	1	22,559	0.0	-	-	-
TOTAL DEPOSITS FSLIC & FDIC		148,561,869				

TABLE III (con't)

QUEENS	# Of Branches	DEPOSITS		MORTGAGE LOAN ACTIVITY		Ratio of Total Loans to Total Deposits
		Total $ Amt. (in 000's)	As a % of Boro's Total Deposit	Total # of Loans	Total $ Amt. (in 000's)	
FDIC INSURED						
American Savings	1	37,335	0.2	4	153	00.41
Atlantic Bank of NY	2	64,460	0.4	28	2,111	03.28
Banco Central	1	1,886	0.0	-	-	-
Banco de Ponce	1	13,274	0.1	12	115	00.87
Banco Popular de Puerto Rico	1	9,854	0.1	2	66	00.67
Bank Leumi	2	33,173	0.2	8	2,359	07.11
Bank of Commerce	4	27,116	0.2	58	450	01.66
Bankers Trust	2	2,628	0.0	20	932	35.46
Barclays Bank of NY	13	166,842	1.1	8	6,631	03.97
Bowerys Savings Bank	4	295,818	2.0	8	380	00.13
Central National Bank of NY	1	3,876	0.0	-	-	-
Chase Manhattan Bank	45	993,935	6.6	138	9,036	00.91
Chemical Bank	22	412,512	2.7	136	13,235	03.21
Citibank	55	1,273,639	8.4	691	34,113	02.68
College Point	2	158,661	1.0	-	-	-
Dime Savings Bank	2	192,186	1.3	82	3,764	01.96
Dry Dock Savings	2	204,963	1.4	32	1,628	00.80
East New York Savings	1	43,607	0.3	14	3,423	07.85
East River Savings	1	77,286	0.5	12	603	00.78
Emigrant Savings	6	352,516	2.3	12	898	00.25
European American Bank and Trust	10	116,667	0.8	22	6,333	05.43
Flushing National Bank	1	34,576	0.2	1	565	01.63
Flushing Savings	2	182,140	1.2	9	220	00.12
Greater New York Savings	1	82,596	0.5	42	1,829	02.21
Greenpoint Savings	2	195,073	1.3	801	39,181	20.09
Hamburg Savings	3	203,212	1.3	80	2,431	01.20
Independence Savings	1	111,956	0.7	3	181	00.16
Jamaica Savings	10	1,011,155	6.7	8	959	00.09
Lincoln Savings	2	269,432	1.8	37	1,793	00.67
Long Island Savings	7	821,055	5.4	358	24,803	03.02
Long Island Trust	1	8,088	0.0	1	900	11.13
Manhattan Savings	1	87,970	0.6	6	269	00.31
Manufacturers Hanover Trust	27	589,246	4.0	81	3,414	00.58
Marine Midland	4	95,117	0.6	45	1,989	02.09
Metropolitan Savings	3	194,939	1.3	16	720	00.37
National Bank of N.A.	17	206,066	1.4	29	4,010	01.95
Peninsula National	2	11,497	0.1	4	278	02.42

TABLE III (con't)

QUEENS	# Of Branches	DEPOSITS		MORTGAGE LOAN ACTIVITY		Ratio of Total Loans to Total Deposits
		Total $ Amt. (in 000's)	As a % of Boro's Total Deposit	Total # of Loans	Total $ Amt. (in 000's)	
Queens County Savings	5	603,016	4.0	41	1,896	00.31
Richmond Hill Savings	5	421,365	2.8	89	3,008	00.71
Roosevelt Savings Bank	4	308,581	2.0	110	9,736	03.16
Ridgewood Savings	5	678,882	4.5	45	1,677	00.25
Sterling National Bank & Trust	4	59,098	0.4	2	2,180	00.30
The Bank of New York	4	46,194	0.3	17	1,387	03.00
Williamsburg Savings	3	157,404	1.0	41	1,735	01.10
FSLIC INSURED						
Allied Fed. S & L	2	18,220	0.1	1	40	00.22
Astoria Fed S & L	11	879,367	6.2	219	11,067	01.26
Bankers Fed. S & L	2	61,821	0.4	1	30	00.05
Bayside Fed. S & L	5	278,186	2.0	49	2,417	00.87
County Fed. S & L	2	106,618	0.7	6	185	00.17
Cross County Fed. S & L	2	35,465	0.2	-	-	-
Edison Fed. S & L	2	49,455	0.3	4	237	00.48
Financial Fed. S & L	4	90,714	0.6	-	-	-
First Fed. S & L of NY	5	115,730	0.8	3	127	00.11
First Federal S & L of Rochester	1	70,720	0.5	-	-	-
Home Fed S & L	6	425,958	3.0	73	2,842	00.67
Long Island S & L	4	206,015	1.4	-	-	-
Maspeth Fed. S & L	4	232,129	1.6	165	6,905	02.97
Pioneer S & L	1	11,993	0.1	20	1,095	09.13
Ponce de Leon	1	7,468	0.1	10	594	07.95
Reliance Fed. S & L	7	300,544	2.1	18	774	00.26
Union Fed. S & L	1	28,961	0.2	3	500	01.73
Whitestone S & L	2	171,610	1.2	23	918	00.54
TOTAL DEPOSITS FDIC & FSLIC		$4,231,665				

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ATTACK ON DEREGULATION RATHER THAN THE MARKETPLACE

The CHAIRMAN. Let me say that I appreciate all of your testimony and each of you bring up some real concerns that all of us are worried about, and I don't disagree with most of the specifics you have enumerated as problems that we need to address.

The only place I have some frustration with your testimony—and not just yours—I don't have to repeat everything I said to the last group—is that deregulation is the cause of the problem, that the legislation is what is creating these activities. That I suppose in this whole process, the whole time I have been on this committee, has been the most frustrating aspect to me.

Let me make a few comments. First of all, you may not have heard me say this and a lot of people out there have many times, but if I had my own preferences, representing a relatively small State—we don't have Citicorp in Utah. We don't have any big banks. Most of our banks are very small. Virtually all of them are under a couple hundred million dollars in assets, very, very small. We only have one so-called large bank and I think it's a hundredth in size, a very small percentage, of the Citicorp, Bank America and so on.

So I represent a constituency that is mostly rural, small banks, and if I had my way, the statement I've made so many times over the years—if we could go back in time far enough to the point where I still had hair, that we would also find a world that banks were in the banking business, savings and loans were in the mortgage lending business, Sears was selling farm equipment and soap and whatever else they do, and Merrill Lynch was in securities, and American Express was in the travel business.

And all of that started to change a long time before I even became a Senator, let alone chairman of the Banking Committee. So I want to emphasize I don't disagree with the concerns that you brought up and that we need to try and rationalize in this process.

I do disagree that the enactment of legislation over the last 3 or 4 years has been the problem that is creating the closing of branches.

I used to like to go to a little Princeton market in Salt Lake City that I used to walk with my mother and drag my wagon around and haul my mother's groceries back from that little store and that was a lot nicer than a big supermarket, a lot more personal, and I still keep my bank account in Salt Lake City. I have never even opened one back here. It's in a much smaller bank because I like the level of personal service that I get.

Now I don't disagree again—I'm trying to make that very abundantly clear to you—I wish the world were that simple again and it was like a rolltop desk where everybody had their pigeonhole and their compartment.

What I tried to respond to is the changes in the marketplace. I found the situation when I started this so-called deregulation process—and by the way, I would indicate to you that if everything was enacted that's been talked about, which it won't be, the financial services industry would still be by far the most regulated industry in this country. So separate financial deregulation from talking about airlines and transportation and trucking and all of that. I mean, nobody's proposals even begin to touch—it's a spit in the ocean—but people tend to do that—that somehow we're going to take all the wraps off the financial institutions--there's no proposal that even touches that.

We also have some 14,000 in this country and yet we always seem to concentrate on Citicorp and Bank America and most of the people of this country are not served by those large institutions. There are thousands of credit unions and there are thousands of small S&L's around this country and that's who serves most of the people.

I want to say that, too. It isn't Citicorp and Bank America, the big boys, because they will take care of themselves. They don't need yours and my help. But there are a lot of small institutions that were on their back and when you talk about mortgage lending and the deregulation that's drying up mortgage credit, we've had testimony just the opposite. In Salt Lake City, the savings and loans testified that on the average new originations in mortgage loans, mostly in single family dwellings, were in excess of 70 percent of their assets since they've been given the new asset powers of 10 percent commercial authority, and yet all the testimony I heard is if you allow them that little basket of 10 percent they'll get out of the mortgage lending business.

At the very time that was passed, there were several S&L's in my State that weren't offering any mortgage loans at all, couldn't afford to, with 5.25 interest rate ceilings being forced by Government regulation and borrowing short and lending long, they couldn't do it. And they had that long trouble list and they said all we can do is quit making mortgage loans totally.

So I made the comment in the hearings in response to that, "Look, if we end up with 50 percent that isn't traditionally where the S&L's have been in the mortgage lending business but it's a lot better than nothing." Well, it's turned out that it's much better than 50 percent.

The statistics across the country in new originations will show you that that is true. And granted, they're in ARM's; they're not in old fixed rate mortgages, but nobody in business—if each one of you were a president of an S&L today and you started making 30-year fixed rate mortgages at 9 percent, you wouldn't be around very long. Until the fundamental cause of inflation is addressed, and that is here in Congress, but that's the problem that I am dealing with, ladies and gentlemen, is trying to address not in a piecemeal fashion. As a matter of fact, that's been one of my major criticisms of Congress. They wait so long until the abberations are so great in the marketplace and then they have a little bill here and a little change there, and that's why I've been trying to address the national policy.

As I've said many times, without any great pride of authorship, I'm willing to listen to anybody and try to fashion legislation that is consensus and compromise across the board with everybody being willing to give a little bit.

So the only thing I wanted to dispell you of. My only real disagreement with your testimony is the attack on the process of deregulation rather than looking at the marketplace.

PROPOSED RESERVE REQUIREMENTS, GEOGRAPHICAL RESTRICTIONS, AND INTEREST RATE CEILINGS DEFEATED

Gale, you mentioned the other alternative. You're correct. You're the only one that's mentioned that. There are two ways you could go. You could either go to the process of deregulation because I don't think any of you would disagree that what was happening to all that money being taken out of the smaller institutions and forcing branch closures and all of that and where it was going. It wasn't staying in Utah, I'll guarantee you. It was going to New York City and the big financial institutions—they're not banks, but the other big financial institutions—and you could say, OK, put reserve requirements, geographical restrictions on them, and interest rate ceilings. And yet I can give you a practical example of that. The Utah Legislature tried to do that and it was overwhelming—I have never—I wasn't even involved. I'm not a member of the Utah Legislature, but I have never had so much mail from so many so-called little people, moderate- and low-income people, individually written letters; they weren't the old form letters, the thousands of cards and so on, saying, "Senator, don't you do one thing that's going to lower my interest rates or we'll be back to get you."

The bankers lost overwhelmingly. They tried. It was Senate bill 134 in the Utah Legislature to tell Merrill Lynch that they couldn't come in with those CMA's, that was banking, and if they did they had to abide by banking regulations. They got killed. And that is the political reality of going that direction. It's just absolutely politically impossible.

The very people you represent were the ones that were just writing me—and I wasn't doing anything. I wasn't there as part of the Utah Legislature. So I don't know how politically, Gale—that was an alternative. It's politically impossible, and we weren't hearing from the big banks. We were hearing from the people each of you represent, in overwhelming numbers, with the handwritten notes that you know nobody called them and said, "Please send this in." They were theirs and they were expressing an opinion like I had never seen before.

So I don't think that is a realistic possibility at all, to go back and try and impose those regulations. I've got testimony here from years back in 1979 from the Gray Panthers against Reg. Q—get rid of those unfair interest rate ceilings; it's terribly unfair for Government to say we only get 5.25 percent. And so to try to attempt to put interest rate ceilings on the money market funds, a snowball's chance in hell is a lot greater than having gone that direction, from a real political sense, if the mail I got is any representation, and I think it is because I saw what happened.

So again, we have to go through this difficult process of trying to rationalize some of these problems and certainly looking at the safety and security of depository institutions, but the greatest threat to their safety and security was new competition which they couldn't compete with at all, just couldn't, and it was an incredible burden, particularly in the mortgage markets with the savings and loans in the position that they were in. The regulations during normal times guaranteed them a profit. You didn't have to be too bright to run a savings and loan because they told you how much you could pay and how much you could charge and just ran it through and then when Merrill Lynch and the others started paying 15.25 percent they were in trouble, and those little savers left them and they were smart enough to leave that 5.25 percent and they didn't have any money.

That's the problem I am trying to address and if any of you would like to make a response to the general problem—I don't understand how you see what we're attempting to do—I'm not talking about specifics. Obviously, there are vast differences of opinions from many groups on the specifics of the legislation. That isn't what I'm talking about. But I'm talking about the need to try and come up with a national policy to deal with the very problems you and others are talking about.

Mr. Nishimura.

Mr. NISHIMURA. Thank you, Senator.

Senator, I agree with you that Gale Cincotta's testimony was very articulate and intriguing. I think what it suggests to me is that the issue is not one of two choices, not the choice of being either black or white; it's a choice of being different shades of gray.

Our suggestion, incorporated in my testimony also, is that where you start from is what you want the banking system to look like, what do you want it to serve, do you want it to serve the neighborhood, do you want it to serve small business, do you want it to serve as an institution where consumers are comfortable and feel safe in depositing their money? Do you want it to serve as an effective tool that the Federal Reserve Board can use in manipulating monetary policy?

I'm afraid that the approach taken in trying to cope with the situation now is not cast in that light. How it is cast is all of these loopholes and all of these State actions and all of these other technological advances, if you will, have created an environment where certain things can happen and are happening, and the only way to make it fair is to allow banks to charge ahead to meet those challenges. And I'm not convinced that that is the proper response for the Senate or for Congress to have.

I think that implicit in that kind of response is the fact that the banking system is going to change dramatically and will not serve the needs in the past. I don't think we've decided that the needs that it served in the past ought to be abandoned. And that's why I guess——

BANK BRANCH CLOSINGS

The CHAIRMAN. I understand what you're saying, but let's go back to the issue of branch closings. I don't think deregulation has had anything to do with branch closings.

You go back and assume that Garn-St Germain or the 1980 Act isn't pass, I don't think that has one thing to do one way or another with whether they make decisions to close banks or not. I don't personally like ATM's. I don't use them. I don't like the impersonality of them.

Mr. NISHIMURA. My understanding is bank branch closing was a direct result of savings and competition in the past when the regulation Q capped effectively the money coming in that banks competed on the level of convenience and therein lie their expansion and branching.

The **Chairman**. Branch closings started because of the high cost of brick and mortar and staffs being maintained in those branches. The banks and savings and loans for a while went out far too aggressively for their own financial good when their profits were high and they were doing very well and it was very competitive—let's put a branch on every corner, just like service stations used to do; you had four on a corner; and they started to retract a long, long time before any of these laws in keeping unprofitable branches open.

What got them into the squeeze and started it more than the laws that were passed were the financial conditions, the squeeze on their profits due to high-interest rates in the general economy.

I really can't accept the fact that this is a matter of deregulation. I think you would have the same branch closings and the same thing going on if we'd never passed a bill.

The question then is: Are you advocating that we should have kept interest rate ceilings? The Gray Panthers aren't going to agree with you.

Mr. **Nishimura**. I think if you'll give me the benefit of speaking from hindsight, I don't think consumers will end up, in general—the masses will end up benefiting from interest rate deregulation. Where we are right now—and I have to admit that we did support getting rid of regulation Q.

The **Chairman**. Do you want to run for public office on the basis of putting interest rate ceilings back on with your members?

Mr **Nishimura**. We're not suggesting that interest rate ceilings be put back and I'm not going to run for office either.

The **Chairman**. You're smarter than I am then.

Mr. **Nishimura**. Mr. Chairman, I think that in retrospect, what we see happening in deposit deregulation is that, the only people who have benefited from deposit deregulation are people who can really put aside $2,500.

The **Chairman**. No. You're down to $250 on the certificates.

Mr. **Nishimura**. If we're talking about CD's, it's $500 and if you're talking about super NOW's or money market deposits, it's $2,500.

The **Chairman**. You're down as low as $250.

Mr. **Nishimura**. But at $2,500, the Federal Reserve Board reports an average rate to savers of over 7 percent on super NOW's and about 8 percent on money market deposits, 2.5 points higher than they would get under regulation Q.

Now as you go down from that you would assume that for lower amounts of money they would be getting far less on their savings. I suppose if we took regulation Q out entirely today, I was told that 5.5 would not move very far, if at all. There's $90 billion in demand deposits that consumers have right now that's earning no interest. There's a portion of the country that just hasn't moved to NOW accounts.

So in retrospect, I think that we're going to find consumers are under the impression that they are going to be getting a great deal of benefit from interest deregulation on their savings, but in fact, the numbers would tend to lessen that estimate.

The **Chairman**. Well, you can always prove anything with statistics, but on the other side of the coin, you'd just be amazed at some of the people that had $2,500 and beyond anybody's wildest imagination, nobody, including this Senator, anticipated that you would have more than $400 billion go zip, the biggest transfer of money in the history of this country, and there are few big deposits, not very many.

I sampled some local banks and it was just absolutely amazing—they obviously didn't tell me who and I didn't ask, but they'd say, "You'd be amazed who walked in with $5,000 and $7,000 and so on and put them into those accounts, who you thought were practically destitute in some cases," an enormous number of people that certainly are not considered moderately rich, at least in the institutions I looked at.

With seven kids and three in college, I don't happen to be one who can afford a super NOW. I can't get up to $2,500.

Ms. **Cincotta**. Some of the people, the way they got into some of those accounts, is that some of their relatives got together to come up with that amount so a lot of that was a family thing as opposed to an individual.

One of the things I wanted to mention on what we talk about in the branch closing or I do is that we see the branch closings as two things: one is the move toward dealing with more upward mobile people, people who have more money. It was a pullout of servicing low- and moderate-income areas. I know a lot of it was overbuilding of branches, but also what I was raising is that when we wrote the Community Reinvestment Act and it got passed, it did not include branch closings.

BRING REGULATIONS UP TO DATE

What I am proposing is that we should take a look at a lot of the regulations and things that are on the book and bring them up to date with all the new things that financial institutions can do, and that it's a twofold thing on branching: one they pull out of certain neighborhoods to deal somewhere else with upscale customers, but when they do, it doesn't come under the Community Reinvestment Act challenge at all. It's just something they can do. Opening a branch does. Closing a branch doesn't.

What I was suggesting is that we're running along without looking at some of the laws we do have. If they've served us well, how do we include them if we do more deregulation? How do we include the Merrill Lynchs of the world under that kind of regulation also? Because they have a lot of money. It's not insured. A lot of the money market accounts are saying "SEC insured." A lot of consumers are reading that, that their accounts are insured, but if you look closely, it means only that they're insured against some fraud but you're not insured like you are in a bank or savings and loan up to $100,000. A lot of people think they're insured under those accounts.

So what we suggest, is that maybe we should include and look at them all—put the Merrill Lynchs, the Fidelity—all these folks who want to get into handling our money. That's why banks are so regulated, because they are handling the money of this country for all of us. If everybody is going to get into the game, maybe they ought to be regulated too and put into one kind of pot for what they can do, be it 5 percent or whatever interest they can charge, so there's some regulation, some control over the money supply in this country, that it does do the purpose of this country and the consumers and the businesses, et cetera, rather than take a piece of it.

The **Chairman**. Well, I understand what you're saying, Gale, but again, I don't know how to get there from here, even if I choose that route to go.

Again, I understand your concerns and I told you what my preference would be, to go back to the rolltop desk, but that isn't possible, to put the genie back in the box, any more than we could require grocery stores to be small and operate on Princeton Avenue. I even used to call up and if I didn't want to haul my wagon, if I wanted to wait a few hours, they would deliver them.

Ms. **Cincotta**. Some still do.

The **Chairman**. What I'm trying to do—I'm not arguing with you on the substance of the bills at this point. I'm talking about the practicalities of politics and maybe I ought to send you the mail I got when they tried to do what you're talking about in the State of Utah, when the banking industry said, "Hey, leave us alone. We just want to be banks. We want to be thrifts and keep those people out, or at least regulate them the same."

So I'm talking to you about the realities of how the people—I'm not even talking now about my colleagues. I'm talking about how the people feel.

Ms. **Cincotta**. People would want to not have money markets regulated for their interest rate—I think they're worried about how much interest they get—as opposed to regulated for their concerns of safety and social purpose. I doubt people would have the same problem with making sure that these new accounts are safe and sound and insured accounts of social purpose. I think what they were talking about in the letters are how much interest do they pay.

The thing that concerns us very much is that if we go and we deregulate further the institutions that are pushing for this are saying that we have 12,000 too many banks in this country and that it really would be more manageable if we didn't have that many banks, if there were a few major banks that held all the capital. We kind of see that's where we're going, more and more away from the neighborhood bank, the neighborhood S&L, the bank within the city or the State, and having any kind of handle—consumers having any kind of handle with just a few institutions in this country. I think that's maybe where we're going to be. If we continue the way we're going, we're going to be talking about how come there are so few institutions left.

The **Chairman**. Again, you heard what I said before to the previous panel about few institutions. We've got to worry about concentration in general. It's almost always concentrated on the banking industry, but if you keep the banking industry regulated and it is politically impossible to regulate the new boys on the block that aren't banks, then what you have is the worry about concentrations, and Merrill Lynch isn't going to put a branch in your neighborhood.

Ms. CINCOTTA. That's for sure.

The CHAIRMAN. Sears isn't going to put a branch in your neighborhood.

Ms. CINCOTTA. Sears is the closest. They have stores all over.

The CHAIRMAN. Well, that's true, but they're still not going to put one just for financial services in your neighborhood.

Ms. CINCOTTA. Right.

The CHAIRMAN. And none of them are. Those industries traditionally have not done that. That is the dilemma again I'm struggling over with you over the general problem and not the specifics of legislation.

Ms. CINCOTTA. If they could immediately through a loophole suck out $400 billion—the money markets—why couldn't we almost immediately do something that would give us some handle on them—some regulation to protect the consumers who put the money in that institution?

The CHAIRMAN. Well, again, you're probably correct. The major worry was what they were going to get paid on their savings and if you're going to treat them equally you would have had to put interest rate ceilings on them, geographical restrictions on where they could operate.

The issue of regulation is a second one that has to come up. When you talk about how the institutions are going to be regulated, I also advocate regulation by function. But until you decide who is going to perform what function, you can't decide who's going to regulate that.

I feel strongly, regardless of who's going to be in the securities business, they ought to be regulated for that business and not the type of brick and mortar structure they call themselves. If Merrill Lynch is going to get into the banking business, they ought to be regulated by a banking regulator. But we can't address those problems until we know who's going to be doing what either way.

If you went the way you want to go and regulate them, you've still got to decide who's got to do what first, if you want to try and go that direction. I would just submit to you that it's politically impossible and I'm not talking about Republican, Democrat, liberal, or conservative politics. I'm talking about the people that I have dealt with across this country and the mail I got not only from my own State about this issue. They want to be paid as much as they possibly can on every dime of their savings, and any threat they see to that—and they see placing regulations on the new competitors puts everybody back into that old regulated 5.25 percent, and they see themselves losing.

I gave up trying to explain that that was not necessarily true. I mean, I literally gave up and surrendered because it was so overwhelming. As I say, I've never seen any issue since I've been in public office where the immediate response was so overwhelming from so many individuals that weren't spurred or were handed a "Copy this and send it to J. Garn." It was an amazing outpouring of public opinion about don't you do that to those people.

Mr. HACKING. Mr. Chairman, I don't want to leave you with the impression that AARP is asking this committee to turn the clock back to some simpler day or to prevent the Sun from rising on a new day. I think that new day is here and we've got to understand that. As a matter of fact, as far as the AARP is concerned, we welcome it.

We started in 1974, urging that regulation Q be phased out so that small savers could avail themselves of market interest rates. But that didn't happen. So to bring a little pressure to bear, AARP established its own money market fund.

A lot of that mail that was targeted on the Utah State Legislature was from AARP members, people whom we kept informed of what was happening. We told them that there was going to be something done to prevent them from having access to market interest rates. We were quite pleased with the effectiveness of our lobbying effort there in Utah.

We recognize deregulation is coming. The organization has been very much in favor of promoting competition. What we're afraid of at the moment in the context of the legislation that's before this committee right now is allowing banks to become involved directly or indirectly in nonbank financial and commercial activities and allowing nonbank financial institutions and commercial enterprises to get involved in banking.

If you look at the banking aspect, the first thing that ought to be undertaken is a complete review and overhaul of the deposit insurance system. We are in favor of competition, but there's a difference between competition among small entities competing on a level playing field and competition among massive financial dinosaurs, some of which would have some very strong advantages because they're backed up by the deposit insurance system as it's currently structured.

The CHAIRMAN. I don't disagree with you, but I am constantly battered about the head and the ears for taking too big a bite and trying to solve these problems now and to try and jump into revising the insurance—you think that doesn't stir up a hornet's nest, too—I happen to believe, coming from the insurance industry, that anything I ever sold was based on risk and so I would believe in risk-related premiums, that if you got a bank that isn't doing as good a job as another, has more risky investments, they ought to pay a higher rate for their FDIC insurance than one who year after year is very conservative, never has any problem loans and does a good job.

Mr. HACKING. That's what we advocate, risk-related premiums.

The CHAIRMAN. Well, I would agree with you on that, but I've got enough to chew on right now without trying to lump that into it as well.

I've got a suggestion that I won't take the time to get into, for revising the whole examination process. Why do you keep going back reexamining the bank that hasn't had any trouble for 50 years on a routine business basis because you're told to, but you don't go back to Penn Square when you know something is wrong? But that's another big apple we will want to bite some day.

I very much appreciate your willingness to testify today and running into your lunch hour. The major point I wanted to make with you again on the overall situation is the longer we wait, however we may agree or disagree—and we have a lot of areas of agreement on specific issues—it seems to me the longer we wait, the more difficult it becomes to make those decisions because the problems grow greater. The marketplace is not going to wait until Congress decides to act.

So I would hope we could at least have your support—again, I expect differences of opinion from your groups and others. That's what this hearing process is all about and why I go through so many hearings and have everybody from every different viewpoint to testify to gather that information, but ultimately at the end of the process, I do believe it's important that we take some action on this. It is important we decide what a bank is, that we define a bank. What is it?

Ms. CINCOTTA. Right. We agree.

The CHAIRMAN. We don't have an adequate definition today. If the decision is that the banks aren't going to be in insurance or real estate, so be it. I'm trying to drive us to get off our fannies in Congress and recognize what is going on out there—whatever the decision of Congress is, let's make the decisions rather than just letting the aberrations continue to occur, and State legislatures do their thing. That's why I'm not in favor of delay. Many of these issues are not new. They have been carefully considered for a long time. The issue of municipal revenue bonds has been passed by the Senate twice 9 or 10 years ago. Some of them are not new or dramatic things that we need to consider for another 3 or 4 years.

So I would just hope that at least there is some common ground, that there are some problems out there that we ought to move ahead on and make some decisions, whatever those decisions are.

Ms. CINCOTTA. I think we agree on that. Thank you.

The CHAIRMAN. Thank you very much. Thanks to each of you for coming.

The hearing is adjourned.

[Whereupon, at 12:30 p.m., the hearing was adjourned.]

[Additional material supplied for the record follows:]

STATEMENT OF COMMISSIONER MARLIN D. JACKSON

ON BEHALF OF THE

COALITION FOR REGIONAL BANKING AND
ECONOMIC DEVELOPMENT

TO THE

COMMITTEE ON BANKING, HOUSING
AND URBAN AFFAIRS

U.S. SENATE

RE: S. 2181, THE FINANCIAL SERVICES
COMPETITIVE EQUITY ACT

MARCH 27, 1984

On behalf of the "Coalition for Regional Banking and Economic Development", I wish to thank Chairman Garn and the rest of the Senate Committee on Banking, Housing and Urban Affairs for the opportunity to present testimony on the omnibus banking deregulation legislation before the Committee. Our Coalition congratulates the Chairman for considering such important and controversial matters in an election year.

The Coalition generally supports the product deregulation provisions of S. 2181 and S. 2134 and, considering the considerable volume of testimony on these matters so far, I will limit my remarks to Title X of S. 2181 and other measures relating to the geographic deregulation of the provision of banking services.

Coalition for Regional Banking and Economic Development

The Coalition is a non-profit group organized to promote the discussion of regional banking at the national level. Its members and supporters include banks from almost every region of the country, banks which are concerned that until now the discussion in Washington of regional banking has been set aside or left to those who favor the abdication of the McFadden Act and the Douglas Amendment to the Bank Holding Company Act.

I personally have been concerned with the question of interstate banking for quite some time, particularly as a banker in my hometown of Paragould, Arkansas when I found Citicorp advertisements in the local paper soliciting deposits for its South Dakota bank. I found this to be yet another example of money center banks eroding the deposit base of the South, a practice which curtails regional and local development in favor of riskier overseas lending.

McFadden/Douglas and Regionalism

This nation has had a long history of decentralized banking, a history which predates and reinforces McFadden and Douglas. The McFadden Act and the Douglas Amendment to the Bank Holding Company Act effectively precluded the cross-border expansion of banks and bank holding companies, respectively, unless a state specifically authorized such actions. Thus, under current banking law each state is a "region" unto itself, unless the State decides to relax its restrictions on out-of-state entry.

The states have recently begun to exercise their rights under federal banking laws to broaden state law permitting out-of-state entities to conduct banking operations within their borders. Some states allow such operations through "grandfather", failing institution or limited purpose statutes. Two states, Alaska and Maine, allow virtually unrestricted entry by bank holding companies. And others permit entry on a regional, or regionally reciprocal, basis. This is consistent with McFadden/Douglas and with this country's historic policy of maintaining a decentralized banking system.

State laws granting the authority to bank holding companies to expand across state lines have received much attention in the past two years. This is the result of the enactment of regional banking legislation in the New England states and of the consideration of such legislation in other areas of the country, particularly in the Southeast. Why is it that regional/reciprocal state banking statutes are causing such a stir?

The reason is that such state statutes run counter to the strategy of some of the nation's most powerful banking institutions. These banks clothe their objections to these state laws in frightful terms like "unconstitutional", "discriminatory", "protectionist", and "anti-consumer". These inaccurate claims are made in contrast, I assume, to these banks' hoped-for radical change in U.S. law and tradition, which would permit unrestricted nationwide interstate banking. The fact of the matter is that regional/reciprocal banking is far from what its detractors claim it to be.

A Positive Expression of States' Rights

Regional/reciprocal banking is a positive expression by individual states of their right to determine the nature of the banking system within their borders. Regional/reciprocal banking statutes provide the opportunity for the opening of state borders to other banks within the region. This added regional competition will provide the consumer with the benefits stemming from better capital flow and increased bank operating efficiency. And regional banking can serve as an engine for regional development, as stronger regional financial institutions provide an inducement for industrial growth and relocation to the area. That means jobs and economic development.

Regions which rely heavily on specific industries have banks with expertise in promoting and lending to them. As an example, I have long been involved in agricultural finance and the promotion of the agricultural economy at the local, state, and national levels, and am confident that a regionally-based bank understands the needs of a farmer in our area better than a money center bank whose main objective, by definition, cannot be regional economic development.

Each state, as it writes its own regional banking statute, determines the states with which it wishes to reciprocate for banking purposes. In the rapidly changing financial marketplace, states need to be able to make conscious decisions about their economic and banking future. States can assess the technological developments and the nature of competition within their borders to determine whether banking law modifications, such as regional/reciprocal statutes, are necessary. Present federal banking laws give the states this freedom to experiment.

There are those banks, such as New York based Citicorp, which tolerate state's rights to change their banking statutes - so long as the bank's purposes are served. For instance, money center banks like Citicorp press in many state legislatures for non-regional reciprocal statutes, or regionally reciprocal statutes with "trigger" dates which eventually eliminate the regional nature of the law. If a law is passed with the "proper" language, it is endorsed. However, if, for example, Citicorp does not like the law as passed in Massachusetts, the statute is "unconstitutional" and "discriminatory", and a lawsuit is filed to overturn the state law which was duly passed by elected state legislators. At the Federal level, Citicorp has attempted to have mergers sanctioned by regionally reciprocal state statutes blocked by the Federal Reserve Board.

We are pleased that the Board of Governors of the Federal Reserve yesterday approved an order permitting the merger of Bank of New England Corporation of Boston and CBT Corporation of Hartford. The approval, we believe, upholds the constitutionality of the Massachusetts' and Connecticut regional banking statutes, upon which the BNE/CBT merger is based.

Support for Regional Banking

The Coalition applauds those, including the Comptroller of the Currency, the Chairman of the Federal Deposit Insurance Corporation, and the President-Elect of the Conference of State Bank Supervisors, who have indicated their support for a Congressional endorsement of regional/reciprocal state banking statutes. We are pleased that others have recognized that the states have a basic right to enact such laws.

To date, the discussion of regional banking has been dominated by money center bankers from Chase Manhattan and Citicorp who oppose it and favor essentially full nationwide interstate banking. That is why I have participated in the "Coalition for Regional Banking and Economic Development". The Coalition is seeking to prevent the undermining of each State's rights under federal banking laws to determine its own destiny with respect to regional banking and economic development.

Coalition Support for Regional Measures

Conceptually, we support the legislative approach to the regional banking question taken by the Chairman in Title X of S. 2181 and by Senator Mattingly in S. 2113. We would, however, take exception to the "sunset" provision found in Title X of S. 2181. We believe that S. 2181's Title X and S. 2113 are merely affirmations of the original intent of the Doulgas Amendment, and that sunsetting this affirmation would be inconsistent with present federal banking law.

The Coalition is concerned that the final language of any Congressional sanction of regional/reciprocal state banking statutes states clearly that such state statutes are unilateral state actions and do not amount to interstate compacts. Failing this, should it be found that statutes are indeed found to be "compacts", it should be noted by Congress that the compacts are not directed to the formation of any combination tending to the increase of political power in the States, which may encroach upon or interfere with the just supremacy of the United States. This is the test the Supreme Court has used to determine the applicability of the Constitution's Compact Clause.

If the courts decide that the Compact Clause should be invoked, a decision with which we would heartily disagree, the legislation before this committee should note that Congress specifically approves of such compacts. This would end all question of the validity of regional/reciprocal state statutes and leave no room for lawsuits which waste the time and resources of banks wishing to exercise their rights under such state statutes.

I will close by again commending the Committee for its fine work on banking deregulation so far. I would recommend that the Committee neither acquiesce to those who would do away with McFadden and Douglas nor permit the continued disruption of the state legislative process by those who are not pleased with its results. I believe that the issue of regional banking is important and that it merits your careful consideration this year.

ATTACHMENT 1

COALITION FOR REGIONAL BANKING
AND ECONOMIC DEVELOPMENT

Counsel:
William K. Dabaghi

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Arguments Against Regional/Reciprocal Banking and Responses to Those Arguments

1. Argument. Regional/reciprocal banking statutes are a violation of the Constitution, particularly the "commerce", "compact", "equal protection", and "due process" provisions.

   Response. These claims are without merit. The McFadden Act and the Douglas Amendment bar interstate banking except to the extent explicitly authorized by state legislation; no "compact" is actually made between states by enacting such statutes, and no encroachment on federal sovereignity inconsistent with the Federal system is made; such an economic regulation rationally related to a legitimate state purpose does not violate the Equal Protection clause; and divestiture ("anti-leap-frogging") provisions of state Acts are rationally related to the legitimate state purpose such Acts are designed to accomplish, and do not involve extraterritorial application of state law.

2. Argument. By passing regional/reciprocal banking statutes, barriers are being erected among the states which are equivalent to the economic "Balkanization" of the states.

   Response. Regional/reciprocal banking, far from erecting new barriers to interstate banking, is actually a liberalization of interstate banking. The states did not, until recently, use their authority under federal banking laws to permit out-of-state banking entry. Currently, states are beginning to use their authority to experiment with regional banking. Far from establishing new barriers to interstate banking, regional/reciprocal banking statutes widen opportunities for broad-based banking within regions. Those who suggest otherwise are confusing the nature of the regional/reciprocal banking approach.

3. Argument. Allowing the formation of larger regional banks will lead to excessive economic concentration and the loss of smaller, community banks.

   Response. Regional banks will never take the place of the small community lender with its intimate ties to individuals and businesses in the community. Regional banks, instead, will increase their capacity to serve the greater needs of a growing, developing business community containing regional and national businesses and industries.

4. Argument. Regional/reciprocal banking legislation is essentially anti-consumer.

   Response. The consumer will be better served by the enhanced capital flow brought on by regional banking, since barriers are being taken down, not erected. Regional banks will be able to operate more efficiently, thereby bringing benefits to the consumer.

5. Argument. Regions for reciprocal banking serve no economic reality and are merely protectionist devices to exclude certain states from entry into regional banking markets.

   Response. Regional banks are economically viable because they are sensitive to the unique needs, attitudes, business practices and commitments of business and commerce within the region. By expanding within a region, these institutions can develop the financial and managerial resources they need to compete effectively and in a safe and sound manner, while at the same time enhancing competition within the region. For example, smaller firms in particular industries may be able to benefit from increased competition by regional banks with experience in their business. Having better capitalized regional banks is an inducement for commercial and industrial growth and relocation, thereby promoting regional development.

   Other realities are at work in addition to economic ones. Regions share common socio-cultural interests, and regional residents will support regional banking growth that leads to better regional benefits. Additionally, those states which fear exclusion are those which already have the largest financial institutions within their borders.

6. Argument. Regional banking statutues are discriminatory and should not be sanctioned by Congress.

   Response. Regional banking statutes are within the framework of the Douglas Amendment and the McFadden Act. These statutes, passed by the individual states, support states' rights to determine their own banking future, as permitted under McFadden/Douglas. States can balance their own local interests with the broadening of economic opportunities of regional banking.

7. Argument. In some respects, *de facto* interstate banking already exists with loan production offices, grandfathered organizations, interstate electronic banking, "nonbank" banks and other entities located throughout the country. McFadden/Douglas restrictions are outdated and should be repealed so that full nationwide interstate banking may occur.

Response. The McFadden Act and the Douglas Amendment are still needed. Presently federal banking laws allow states to make conscious decisions about their economic and banking future while providing needed direction to the rapid economic change in the marketplace. It allows states to assess the technological developments and the nature of competition within their borders and regions to determine whether reciprocal banking legislation would be desirable. This is a state's prerogative and should be respected by the federal government.

8. Argument. If regional/reciprocal banking statutes do not violate the "compact clause" of the Constitution, there is no need for Congressional sanction of regional banking.

Response. While there is no legal need for these statutes to be certified by Congress, there are other reasons why these statutes should receive Congressional sanction. Opponents of these statutes are forcing costly court battles in relation to the statutes in New England and have stated that they will do so elsewhere. The expense, uncertainty, and waste of time caused by such suits make it appropriate for Congress to explicitly sanction regional, state passed, statutes.

9. Argument. Regional/reciprocal banking statutes, if they are enacted, should have a "trigger" date which would open the state and/or region to full interstate banking after a stated amount of time.

Response. The states are acting as laboratories of innovation for the experiment of regional/reciprocal banking. Mandating that states accept full interstate banking, even on a reciprocal basis, after a period of time would remove the experimental nature of such statutes. States should be given the freedom to evaluate their own banking systems and the impact of regional banking and then decide for themselves whether to allow full interstate banking.

10. Argument. Bank shareholders would obtain a better deal for their stock in an interstate acquisition or merger if it takes place in an environment of total interstate banking.

Response. While there is the possibility that shareholders could receive more money for their stock in a national market, such a transaction is a one-time occurrence. The long-term profitability of a regional bank, which is investing in a growing and developing regional economy, would be more profitable to the shareholder in the long-run.

ATTACHMENT 2

S&FA
State and Federal Associates, Inc.
1101 15th, N.W., • Washington, D.C. 20005 • (202) 467-6390

March 23, 1984

INTERSTATE BANKING IN SELECTED STATES

COLORADO

There has been some discussion of regional reciprocal interstate banking in Colorado, but no legislation has been introduced and none is expected this year. Nationwide reciprocal interstate branching for savings and loan associations was considered this year, but that bill, H.B. 1257, died in the House Business Affairs Committee.

CONNECTICUT

Connecticut currently permits regional reciprocal interstate banking. A bill, S.326, is pending, however, which would permit nationwide reciprocal interstate banking. This bill has been reported favorably by the Joint Committee on Banks and is on the Senate calender. Enactment is unlikely unless the bill is necessary to overcome Federal Reserve denial of mergers between New England banks.

FLORIDA

Two interstate banking concepts are being considered in Florida: (1) the Governor's proposal calls for regional reciprocal interstate banking, with the region consisting of the Southeastern states; and, (2) an alternative proposal introduced by Senator Gordon also calls for this regional approach, but with two modifications (a) institutions from any state would be able to acquire a Florida bank provided that bank had assets of less than $400 million, and (b) after 5 years, the regional barriers would dissolve in favor of nationwide interstate banking without asset limitation. The debate in Florida is expected to be vigorous, and the outcome is unclear.

ILLINOIS

Nationwide reciprocal interstate banking would be allowed if H.B. 1063 were enacted. This bill is pending in House Committee and could see some action later in the 1984 session. Similar bills have been introduced, considered, and not enacted in each of the last several years in Illinois.

MARYLAND

Companion nationwide reciprocal interstate banking measures are pending in Maryland legislative committees. The House Economic Matters Committee has

Note: This document was prepared for the Coalition by State and Federal Associates. The analysis contained herein is theirs.

H.B.323, and the Senate Economic Affairs Committee has S.B. 425. Deadlines have passed for Committee consideration of these bills. Thus, unless rules are suspended, these bills will receive no further consideration this year.

MICHIGAN

Last year, S.B. 369 was introduced, and it would permit nationwide reciprocal interstate banking. Because Republicans gained control of the Senate in special elections in January, however, the sponsor of the bill, who had also been Chairman of the Committee, is no longer a member of the Committee. Whether the bill will receive attention under Republican control is unclear, there is substantial opposition to it.

NEVADA

The Nevada Legislature does not meet in regular session during 1984, but a special session has been called for March 28 in order for it to consider nationwide interstate banking legislation. If legislation is enacted during this session, it could require reciprocity, although that issue has not been decided, and it will allow interstate banking on a limited basis only. For example, the bank acquired by an out-of-state bank holding company would not be allowed to solicit deposits or commercial loans, and a minimum of $5 million must be invested in the state by the acquiring institution.

NEW HAMPSHIRE

The New Hampshire Legislature does not meet in regular session this year. A study committee was initiated in the last session to review the issue of interstate banking. That committee continues to meet, and is looking seriously at nationwide interstate banking. Interstate banking is therefore likely to be a major issue for the 1985 regular session.

NEW JERSEY

The New Jersey Legislature has not considered interstate banking legislation, but the Bankers Association has had this issue under consideration for several months. The Association recently announced its support for regional interstate banking for three years, with nationwide interstate banking being permitted after that three-year period. It is not clear, however, that the Association's support will translate into legislation for consideration in the 1984 session.

PENNSYLVANIA

The Pennsylvania Legislature has not considered interstate banking legislation, but there have been discussions of regional reciprocal interstate banking by various members of the banking community as well as by the Bankers Association. Currently, it is not expected that interstate banking legislation will be addressed this year.

TENNESSEE

The Tennessee Legislature is not expected to consider interstate banking legislation this year. Currently, one of the focuses in the banking area is the closing of a "loophole" that could have permitted Citicorp to gain an industrial bank charter.

UTAH

The Utah Legislature adjourned its 20-day regular session on January 23, but a special session on education and other issues has been called for March 26. One of the other issues that is likely to be discussed during this special session is regional interstate banking. The region being discussed encompasses all western states, excluding California. There appears to be significant support for such a proposal and chances for passage are good.

VIRGINIA

The Virginia Legislature has adjourned its 1984 legislative session, and interstate banking was not considered. Currently, the Legislature is not expected to be called into special session this year.

WISCONSIN

Interstate banking was a major topic this year in the Wisconsin Legislature. A.B. 800, which would have provided for nationwide interstate banking was amended in Committee to provide only for regional interstate banking. This region would have included surrounding states in the Midwest, and the bill would have been effective when three states in the region enacted reciprocal legislation. Even this limited approach failed in Committee, however. The Legislature adjourns its 1984 regular session on April 6, but it is likely that a legislative study committee will review this issue during the interim months. Prime supporters of this issue in Wisconsin are large bank holding companies from Minnesota, and the issue is certain to be reconsidered in 1985.

NRMA

National Retail Merchants Association

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STATEMENT FOR THE RECORD

OF

NATIONAL RETAIL MERCHANTS ASSOCIATION

BEFORE THE

COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS UNITED STATES SENATE

HEARING ON CREDIT CARD SURCHARGES

February 29, 1984

EXECUTIVE OFFICERS

Chairman of the Board
WILLIAM P. ARNOLD
Chairman and Chief Executive Officer
Associated Dry Goods Corporation
New York, New York

First Vice Chairman of the Board
SUMNER FELDBERG
Chairman of the Board
Zayre Corp.
Framingham, Massachusetts

Second Vice Chairman of the Board
CARROLL E. EBERT
Chairman of the Board and President
Carson Pirie Scott & Co.
Chicago, Illinois

President
JAMES R. WILLIAMS
NRMA
100 West 31st Street
New York, New York

Home Office: 100 West 31st Street, New York, N.Y. 10001

The National Retail Merchants Association (NRMA) is pleased to submit this Statement for the record in connection with this Committee's deliberations on credit card surcharges.

NRMA is the nation's largest trade association for the general merchandise retail industry. NRMA's members operate approximately 40,000 stores in the United States, distributing in excess of $175 billion annually in goods and services to the American consumer. NRMA's members range in size from the largest chain and department stores and mass merchandisers to small specialty shops and independents.

Virtually all of NRMA's members extend credit by means of their own proprietary credit card systems or by accepting third-party credit cards, and some members offer both alternatives to their customers.

On February 22, 1984, the Senate Banking Committee passed a bill to extend the ban on surcharges until May 15, 1984 and at the same time passed a Committee Print that would remove the ban on surcharges and treat "differences in price" of 5 percent or less as exempt from state usury laws. Under the Committee Print such differences in price are also excluded from treatment as a finance charge under the Truth-in-Lending Act. NRMA endorses the Committee Print.

In view of the fact that over 50 percent of our members' sales are made by means of credit cards, the issue of the legality of imposing a surcharge for the use of credit cards is an extremely important issue for retailers. A surcharge for credit is potentially a viable pricing mechanism. Unlike discounts for cash, as a practical matter, a surcharge for credit is a realistic possibility for many merchants. On the other hand, discounts for cash present substantial administrative obstacles at the point-of-sale. This is one of the principal reasons why discounts for cash have received comparatively little acceptance by retailers, with the notable exception of operators of gas stations. Only about 6 percent of retailers other than gas station operators offer such discounts, according to the Federal Reserve Board's recent credit card study.

NRMA did not oppose legislation passed by the House on November 16, 1983 (H.R. 4278), which would extend the current ban on surcharges until July 31, 1984. Now, however, we are convinced that the approach of the Committee Print is the best solution. After considering the divergent views of consumers (at least as consumers' views are purported to be represented by the Consumer Federation of America), third-party credit card issuers, and businesses that accept such cards, and others such as the Federal Reserve Board, the

Senate Banking Committee has achieved a fair balance. Even though excluding from the finance charge and from disclosure under the Truth-in-Lending Act only surcharges and discounts of 5% or less effectively would eliminate any surcharges or discounts in excess of that amount, this approach is preferable to a continued ban on surcharges.

Until now, most retailers have not considered the issue of two-tier pricing to be very significant, essentially because surcharges have been illegal and, as noted, discounts for cash have been impractical. The bookkeeping and other logistical problems involved with returning part of the cash price to the cash customer, along with the confusion this could cause on the sales floor, has militated against offering discounts for cash. This does not mean that surcharges would suddenly become commonplace if the ban is removed. Even if the impediments attributable to disclosure requirements under Truth-in-Lending and state finance charge ceilings are removed, imposition of a surcharge is highly unlikely in the context of a merchant's proprietary card. In the case of the merchant's acceptance of third-party cards, the imposition of a surcharge will be given consideration by retailers who are concerned about their cash customers subsidizing the cost of credit but have been reluctant to offer a discount for cash. Further, many of the retailers and gas station operators who in the past have offered discounts for cash are likely to switch to the surcharge method of two-tier pricing and abandon the discount for cash approach entirely.

Thus, a subject that in the past has largely been irrelevant for retailers now is important. We recognize that surcharges could play a significant role in the economics of extending credit for thousands of merchants, from large chains to small specialty shops, and thousands of others such as restaurants and hotels. Virtually every business that accepts third-party credit cards and pays the "merchant discount" will for the first time at least consider the merits of passing that cost on to the customer to whom that cost can be directly attributed. There is another consequence of removing the ban. If debit cards are ultimately priced as we believe they should be -- on a per transaction basis instead of a merchant discount basis -- removing the ban on surcharges for credit card use could be the single most positive influential factor for debit cards to date. Retailers will be able to accept debit cards at full value, which they want to do because debit cards are considered an alternative to accepting currency or checks, while possibly placing a surcharge upon credit cards.

NRMA thus supports lifting the ban on surcharges. We see no basis for distinguishing, from an economic or legal standpoint, between discounts for cash and surcharges for credit. They are functionally the same. Admittedly, both types of two-tier pricing can produce confusion on the part of consumers and there is the potential for abuse on the part of a few unscrupulous entrepreneurs who fail to comply with the requirement to disclose the existence of a surcharge before the customer makes the decision to make a purchase. In spite of this, limiting the marketplace to one type of two-tier pricing system should not be perpetuated.

As the Board has pointed out, there is a cost attributable to credit card financing which is not at the present time being allocated fully to the users of credit cards. While the amount of the subsidy that is paid by cash customers is disputed by issuers of third-party cards, we are convinced -- and the Board's study is corroborative -- that the cost of both proprietary and third-party credit card systems is not offset by the revenue derived from those consumers who use those systems. Many who use credit cards are convenience users who pay nothing to use the merchant's proprietary card plan (fees are rarely if ever imposed on merchants' own cards) or pay only an annual fee and sometimes no fee to use third-party systems. Study after study over the years has documented the fact that the finance charge revenue available to the merchant is insufficient to pay the tremendous costs of operating a proprietary system. Similarly, when the merchant accepts third-party cards these costs are either absorbed to reduce profits or are passed on in the cash price of the goods and services, to be shared by both cash and credit card customers. The argument that in fact the merchant's cash price is "pure" -- it excludes the costs incident to operating the in-house credit facility or paying the "merchant discount" imposed by third-party card issuers -- because of the increased volume attributable to credit card sales, still has not been documented. While it cannot be denied that there are some incremental sales attributable to accepting credit cards, all available data, including the Board's recent study, indicates that for many merchants this is not sufficient to eliminate a subsidy by cash buyers.

NRMA believes that merchants and others should not be restricted in the way in which they price their goods. There is no public policy justification for limiting merchants to recouping the additional expense of third-party credit cards by the sole means of a discount for cash. It has been demonstrated that this mechanism is simply not a realistic alternative for most merchants. On the other hand, a surcharge might be. The key question is whether there is an overriding need to restrict the marketplace in this way. The answer is that there is no such need.

The advocates of the ban have not offered compelling reasons to justify its continuation. Their position is that if merchants want to recoup their credit card expenses, there is a mechanism (discounts for cash) available to the merchant. The fact that discounts are difficult to administer and impractical to implement is of no concern to those who oppose surcharges. They also cite the problems that might arise concerning potential confusion on the part of the consumer or potential abuses on the part of those imposing surcharges. The answer is that these problems are addressed in the Committee Print and any needed refinements can be developed in the Board's implementing regulations. For example, a business should be required to clearly disclose the existence of a surcharge (such as by indicating such in connection with the third-party card logo) before the consumer makes his or her decision to purchase goods or services, rather than only at the time of payment. These concerns have been resolved satisfactorily in the case of discounts for cash and we are confident the Board will deal with them effectively in the context of surcharges for credit.

In summary, while we do not oppose extending the ban on surcharges for a short period, it is essential that this issue be carefully examined now and that a final resolution be achieved. This should be done with as much expedition as possible because failure to act has the effect of continuing the ban. This is because the point-of-sale disclosure requirements under Regulation Z and the fact that the surcharge would be a finance charge for purposes of state law should effectively prevent their implementation. Thus, we urge Congress to promptly resolve this issue once and for all by removing this restriction on the ability of merchants and others to allocate the cost of credit in a way that is best calculated to avoid a subsidy by cash purchasers. This would leave the Truth-in-Lending Act intact to insure adequate disclosure of the cost of credit, with a specific and carefully delineated exception for certain point-of-sale discounts for cash and surcharges for credit.

NRMA appreciates the opportunity to present the views of its members on this important issue.

[Response to written questions of Senator Garn follows:]

CFA

Consumer Federation of America

MEMORANDUM April 17, 1984

TO: Senator Jake Garn, Chairman
Senate Banking Committee

FROM: Glenn Nishimura, Legislative Representative
Consumer Federation of America

RE: Response to April 5 Letter from Committee

Your letter of April 5th requested my comments to two follow-up questions relating to my testimony before the Senate Banking Committee on S. 2181 and S. 2134, financial institutions deregulation legislation. Your paraphrased questions and my responses follow:

1 - (from Senator Garn). Because of the rapidly changing marketplace, we can't afford the luxury of a "go slow" approach. Legislation is needed this year. Moreover, consumers seem to want access to a broad range of financial services from one provider. Comment?

The question is properly separated into two distinct parts. First, what should Congress do in the face of marketplace change? Second, are these changes "consumer driven" and what does that imply?

As to the first point, CFA's recommendation to "go slow" is directed at the prospect of further deregulation of the financial market. Our testimony supported the closing of the nonbank bank loophole and the South Dakota loophole as actions that would promote a measured approach. Left unchecked, these loopholes will lead to financial services deregulation that would be driven by institutions fearful of being outdone by their competitors. Congress must stop the circumvention of the intent of the law and must prescribe a rational, useful financial system. Failure to do so may result in a network not responsive to the need for a sound financial system and unable to be used to implement national priorities.

On the second issue, Congress should be wary of the assumption that deregulation is occurring because consumers are demanding it. Banks are demanding deregulation. Loophole jumping by banks and nonbanks is driving deregulation. The fact that some consumers purchase new products and services should not be regarded as evidence that consumers approve of the more fundamental marketplace changes. Moreover, the competition that has emerged has been primarily directed at the affluent parts of the population. Competition for that affluent market has affected the way in which financial institutions service the less affluent market. Congressional oversight should extend not merely to the purported benefits of increased competition, but also to the other side of the deregulation

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coin - impact of service to the general population, ability to achieve national priorities, and confidence in the soundness of the system.

2 - (from Senator Mattingly). The New York Temporary Commission on Financial Services has recommended that banks be permitted to engage -- over time -- in new service such as insurance. Please comment.

CFA is not unalterably closed to the proposal of allowing banks to enter other areas of financial services. We do believe, however, that at present, there are too many unanswered questions to allow such a move. Will a separate subsidiary structure sufficiently protect government-insured funds from being used in risky competitive ventures? Has bank entry into credit insurance resulted in lower prices for consumers? How will such a change affect the relationship between banks (as lenders) and their competitors such as independent insurance agents (as borrowers)?

While CFA believes that consumers could benefit from a more competitive insurance industry, it is important to consider the question of expanded powers in the context of the effects on the entire financial system. And though convenience is being touted as a major benefit to consumers, considerations of convenience must take a back seat to questions about soundness, concentration, and consumer confidence. Furthermore, the Commission argument about the likelihood of keeping branches open if banks are allowed to get into insurance is pure speculation. Bank entry into the insurance business is a risky venture. But, even if banks are successful, there are no guarantees that that success will translate into more bank branches.

AMERICAN
ASSOCIATION
OF RETIRED
PERSONS

25 YEARS OF SERVICE

April 11, 1984

The Honorable Jake Garn
Chairman
Committee on Banking, Housing
and Urban Affairs
U. S. Senate
Washington, D. C. 20510

Dear Chairman Garn:

This is in response to your letter of April 5th requesting our reply to the question raised by Senator Mattingly at the February 29 hearing held by your Committee.

Question from Senator Mattingly:

Realistically, since it does not look like the Congress will address regulatory issues this year, are you suggesting we hold off any action for another year or more?

Answer from James Hacking (AARP):

We are strongly suggesting that no action should be taken this year that would free commercial banks to engage in business activities which have been historically barred to them. The point we have been stressing is that commercial banks have a number of government-provided advantages which make them unfair competitors of financial institutions or commercial enterprises which lack these advantages. The administration of deposit insurance by the government has resulted in de facto guarantees of all the bank creditors in the event the bank becomes insolvent. This provides a commercial bank with important amounts of implicit capital. The federal government routinely provides lending facilities to commercial banks and loans when insolvency is threatened (so-called loans of last resort). In addition, the government may take other steps to avert damaging threats to the banking system (for example, advances may be made to international lending institutions which, in turn, may make advances to bank debtors that may be in difficulty). We believe these government-provided advantages to commercial banks should be carefully studied by Congress, before passing legislation to widen their business line. Particularly, the deposit insurance system should be modified so that if commercial banks engaged in activities which entail higher risks of losses, they will bear higher insurance premiums. If Congress does not do this, the logic is that financial institutions competing with commercial banks will ask for the same government advantages provided to the commercial banks. The taxpayer will end up supporting all these subsidies.

Sincerely,

James M. Hacking
Assistant Legislative Counsel

JMH:RWB